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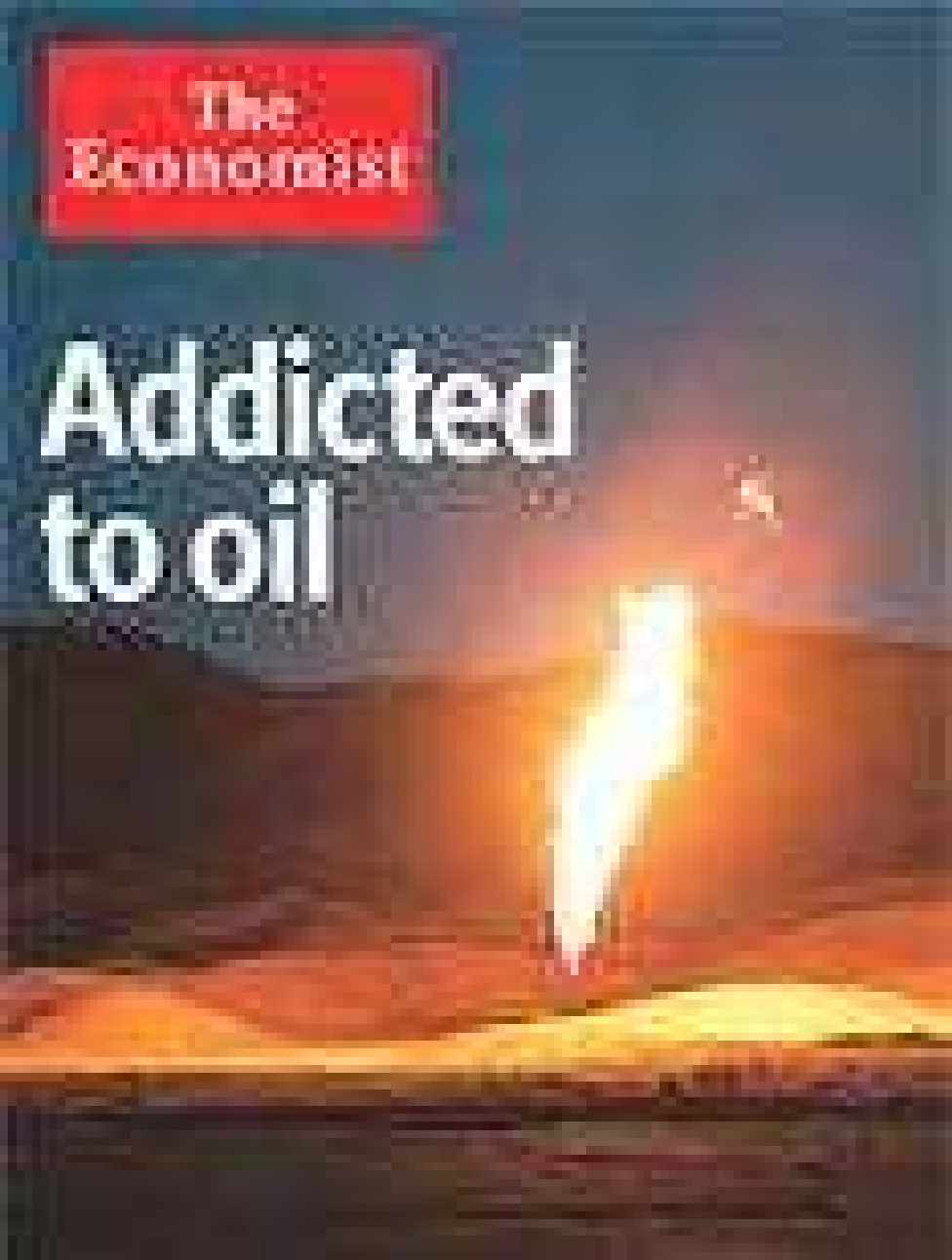
Addicted to oil



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Politics this week

Dec 13th 2001
From The Economist print edition

No surrender, yet

EPA

Al-Qaeda fighters holed up in the Tora Bora area of **Afghanistan** showed no sign of surrender, despite punishing American bombing. A new deal was offered to al-Qaeda diehards: surrender Osama bin Laden and his close comrades and go free. Some thought Mr bin Laden had fled to Pakistan.

See article: How to keep the peace in Afghanistan

France said it was ready to commit troops to a multinational **peacekeeping force** in Afghanistan. Britain was set to lead it, although Tony Blair, Britain's prime minister, said that many details still had to be resolved.

A Somali militia leader alleged that the al-Qaeda terrorist network was moving its operations to **Somalia**, a mostly Muslim country in a state of chaos. American officials said that they were investigating, but played down the possibility that military strikes were imminent.

John Ashcroft, America's attorney-general, charged a Moroccan-born Frenchman with conspiring with al-Qaeda to carry out the **September 11th terrorist attacks**. Zacarias Moussaoui, who had undertaken pilot training in Minnesota, could face trial by a secret military tribunal.

Violence in the Middle East

Israel ended all direct contact with **Yasser Arafat** and struck at Palestinian police stations and other targets after ten Israelis in a bus had been killed by gunmen near a Jewish settlement in the West Bank. A Fatah militia group and Hamas both claimed responsibility for the attack, saying that it was in revenge for recent killings of Palestinians by Israel's forces. Mr Arafat moved to close down all Hamas and Islamic Jihad offices.

See article: The pushes and pulls on Yasser Arafat

Saudi Arabia's interior minister, Prince Nayef, announced that for the first time identity cards, carrying photographs of their unveiled faces, would be issued to Saudi women under certain conditions. Hitherto, a woman has been named only as a dependant on the card of her father or husband.

Ruud Lubbers, the UN high commissioner for **refugees**, accused governments of basing their policies towards the world's 22m refugees on “fear and mistrust”.

Zimbabwe's president, Robert Mugabe, announced that a long-awaited **presidential election** will be held in March.

Yesterday's treaty

EPA

President George Bush said he would give Russia notice that America will withdraw from the 1972 **anti-ballistic missile treaty**. Mr Bush said the treaty was written in a “different era for a different enemy”.

See article: George Bush's arms-control hang-ups

A presidential commission unanimously backed three recommendations that would allow young workers to invest part of their **Social Security** contributions in the stockmarket. The decision came as concerns grew over financing the retirement years of the baby-boom generation. The chances of action seem slim.

See article: Social Security reform, bogged down

Police in Los Angeles arrested two leaders of the **Jewish Defence League** on charges of trying to blow up a mosque and the office of an Arab-American congressman.

Italy retreats

Italy's prime minister, Silvio Berlusconi, gave way to his EU partners and accepted plans for an **EU-wide arrest warrant**. Italy had objected to the long list of crimes it would cover. Changes in the Italian constitution will be needed. Mr Berlusconi's Northern League allies were dismayed, both by the warrant itself (too much foreign meddling) and by his readiness to yield to EU pressure.

See article: Italy oddly at odds with Europe

In advance of an **EU summit** at Laeken, in Belgium, the president of the European Commission, Romano Prodi, attacked members for agreeing to plans but then not carrying them out (eg, the proposed “Galileo” European global-positioning system). EU summits might become mere high-level talking-shops, he suggested. Become? jeered cynics.

See article: Towards a bigger, simpler Europe

In **Britain**, dispute arose over urgings by David Blunkett, the home secretary, that immigrants should do more to adapt to British ways, and over a report on some race riots earlier this year, which lamented that brown and white communities live almost entirely apart. He proposed more emphasis on the use of English, and a new oath of allegiance for people seeking naturalisation.

See article: Race, nationality and loyalty

An international tribunal in The Hague indicted **Slobodan Milosevic** for genocide during the early-1990s civil war in Bosnia. The former Yugoslav dictator refused to plead, calling the charge a “monstrous absurdity”.

Fourteen British and Dutch plane-spotters who had been held in prison in **Greece** on charges of spying were offered bail.

Killing in India

Five gunmen broke into **India's** parliament buildings. In the ensuing battle, they and at least six other people including policemen, though no MPs, were killed.

See article: An attack on India's parliament

One week after a new government was elected in **Sri Lanka**, bringing the prospect of peace talks with the separatist Tamil Tigers, the rebels attacked a police station and an army post killing ten people. Six Tigers were reported to have been killed.

Nine hereditary rulers of **Malaysia** chose Syed Sirajuddin, the ruler of Perlis state, as the country's new king for the traditional term of five years.

Reuters

Tung Chee-hwa, picked by China to run the former British colony of **Hong**

Kong, is to run for a second five-year term.

Jiang Zemin became the first Chinese head of state to visit **Myanmar** since the military junta seized power in 1988. China supplies Myanmar with most of its arms.

Cheesed off with Chavez

Venezuela came to a standstill in a one-day stoppage organised by private business and backed by labour in protest at decrees issued by President Hugo Chavez. The president threatened to “turn the screws” on the opposition.

See article: Venezuela's polarised politics

Argentina limped on. Domingo Cavallo, the economy minister, said he would keep his promise to the IMF of a balanced budget next year by scrapping earlier tax cuts.

See article: The IMF pulls its punches with Argentina

Trinidad and Tobago's second general election in a year failed to break a political deadlock. The government and opposition each won 18 seats. The rival leaders held talks on a possible coalition.

See article: Trinidad's tied election

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Business this week

Dec 13th 2001
From The Economist print edition

Downward march

America's Federal Reserve responded to continuing signs of economic weakness with its eleventh **interest-rate cut** of the year. A reduction of a quarter-point brings rates down to 1.75%, the lowest for 40 years.

See article: Reasons to wait for a boom

The value of **global merger and acquisition activity** in 2001 was $1.6 trillion, half what it was worth the previous year, according to data from Dealogic. In 2000, the inflated value of high-tech shares fuelled many a deal that now looks unwise.

CSFB is to hand over some of the cash it had made from the dotcom boom. The investment bank has reportedly agreed to pay $100m to settle an investigation by America's regulators into claims that it had rigged initial public offerings of high-tech shares by allocating big tranches to favoured customers in return for a slice of the profits in the form of inflated commissions.

Zurich Financial Services reshuffled its top management yet again. Dinos Iordanou, who had been promoted to head of group operations last year and was tipped to take over the top job, left to run an insurance start-up. Perhaps as a result, Converium, a reinsurance business Zurich has spun off, made a quiet stockmarket debut.

The weak economy claimed more victims at **American Express**. It announced that up to 6,500 more jobs would go, on top of the 7,700 announced in the past 12 months, a total of 15% of its workforce.

Compaq's merger with **Hewlett-Packard** seemed doomed after the Packard foundation rejected the deal. Hewlett family members had already dismissed the merger; together they own 18% of the company. Compaq shares sank, but both it and HP optimistically insisted that the deal would succeed with the aid of institutional shareholders.

See article: Carly Fiorina of Hewlett-Packard

Telecom troubles

The global telecoms slump hit Eastern Europe. **Telekomunikacja Polska** announced that it would get rid of 12,000 employees next year, some 20% of its workforce. France Telecom, which acquired 35% of the former state monopoly from the Polish government last year, had said that job cuts would come but had agreed with powerful unions that it would wait four years.

Struggling **British Telecom** appointed Ben Verwaayen, a Dutchman from struggling Lucent Technologies, as its new chief executive, to replace Sir Peter Bonfield, who recently said he would depart from BT a year ahead of schedule.

Nokia provided some relief from the gloom surrounding high-tech companies. The Finnish mobile-phone behemoth announced that fourth-quarter profits were likely to be better than previously forecast after handsets sold in greater quantities than expected. But fourth-quarter profits will not match last year's; and its infrastructure business still languishes.

Consignia, once known as Britain's Post Office, may have to lay off some 30,000 workers over the next year and a half, twice previous estimates for redundancies needed to save costs as postal growth slips. Unions reacted to the state-owned company's announcement with outrage and threatened to strike.

Yahoo!, the world's biggest Internet portal, made an unsolicited offer of $436m for **HotJobs**, a careers website that was planning to merge with its rival, TMP Worldwide.

Drug culture

Corporate Japan suffered its biggest foreign intrusion with the purchase by **Roche** of a controlling interest in **Chugai**, a large drug company, for up to ¥198 billion ($1.59 billion). The Swiss drug firm assuaged Japanese sensitivities by dressing the deal up as an alliance with Roche as an invited partner.

Pfizer threatened to stop supplying France with new medicines in protest at the country's drug-pricing policies. It hopes competitors will join the struggle to squeeze extra cash from France's government; it would go to research and developing better cures, says Pfizer.

Merck shocked investors and sent its shares reeling with the news that profits would not grow in 2002. The American drug firm blamed the expiry of patents and slowing sales.

Fixing the car maker

Fiat unveiled plans for a restructuring that would see the loss of 6,000 jobs, the sale of non-core assets and the possible demise of up to 18 of its factories. The head of its car-making division, Roberto Testore, resigned.

See article: Fiat's problems

Five **German banks** felt the wrath of the European Commission. In its latest round of cartel-busting, the commission levied fines of *euro*101m ($90.4m) for fixing commissions on the exchange of the 12 euro-area currencies since 1997. Three banks said they would appeal.

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Energy and geopolitics

Addicted to oil

Dec 13th 2001
From The Economist print edition

America's energy policy was wrong before September 11th. Now it is even more so

IF SEPTEMBER 11th really did change the world then one thing it changed, you might suppose, is how the West, and in particular the United States, should think about energy. America's dependence on oil imports from the Middle East has led it to see the stability of the region as a vital security interest. In defending this interest over the years, its military and political entanglements have grown more costly and more complicated. In some ways, it is argued, these policies may have become self-defeating. America's military presence in Saudi Arabia, for instance, may make the region less stable, not more. All of which leads some to conclude that America and the West should henceforth minimise their involvement—economic, political and military.

Is this right? Put so baldly, no. The West's energy policies, and its political relationship with Middle Eastern oil producers, do need to be re-examined. But the issue is subtler than the debate between “engagers” and “disengagers” implies.

Varieties of dependence

The key fact is this: Saudi Arabia has enormous reserves of oil that can be extracted at very low cost. Regardless of western policies, its oil will flow on to the market and, in effect, set the world price. This makes “dependence” on Saudi Arabia an inescapable reality for years to come. Even if America were self-sufficient in oil production, the price of OPEC output, meaning mainly Saudi output, would still largely dictate the world price. With or without new fields in Alaska, or wherever, the only way to break that link would be a naval blockade to keep foreign oil out—not an easy policy to explain to voters.

Yet this economic dependence, you could argue, need not dictate political or military engagement in the region. Even though Saudi Arabia, as owner of the biggest and cheapest reserves, is the dominant producer, its oil is no use buried under the desert. The long-term trend in oil prices has been slowly down, a consequence of greater energy efficiency and better oil-extraction technologies. So oil in the ground has been a depreciating asset. Saudi Arabia can be relied on to keep pumping because it has a compelling interest in doing so. At the same time, its ability to gouge the West will be capped by fear of new energy-saving investment.

On this view, dependence on Middle Eastern oil may be a fact, but it is easy to live with. America has no need to commit blood or treasure to keeping “friendly” governments in power. That calculation should be made on other grounds. So far as economics goes, who controls the oil hardly matters. Saddam Hussein is as keen as anybody else to get his oil to market. This logic applies to all producers: oil will flow at affordable prices and, so long as energy markets in the West are free to adjust to fluctuations in demand and supply, all will be well.

Until September 11th, the “benign dependence” theory was persuasive

Until September 11th, this “benign dependence” theory was persuasive. Certainly, it fit the facts. Looking forward, it admittedly played one thing down. A helpful influence on the oil market has been growth in non-OPEC supplies. Saudi Arabia remains the swing producer (the price-setter), but, as non-OPEC

supplies increase, its freedom of action is curbed. The cartel's failure in recent weeks to agree on immediate production cuts was partly due to the refusal of Russia, a non-member, to join in. If there were ever to be an interruption in Saudi supplies, it would be far easier to cope with if the Saudi share of the market continued to fall.

The trouble is, it won't. Instead, Saudi Arabia's share is sure to rise in coming years. Easily extracted non-OPEC reserves will dwindle, even on optimistic assumptions about technological progress. Dependence on Saudi oil is not going to keep on fading—quite the opposite (see article). This is a pity, to be sure, but it does not really change the earlier conclusion: that “dependence” is unavoidable, but it need not be a problem.

Something happened

Or so it seemed before September 11th. Now, there is a new fact—or rather an old fact, newly apparent. It may not matter, so far as the price of oil is concerned, whether the Saudi regime is friendly to the West, but it certainly matters whether it is rational. The previous arguments assume that Middle Eastern oil producers will know what is good for them. But if a Taliban-like regime were ever to gain control of the Saudi oilfields, could it be relied on to maximise profits in a sensibly self-interested fashion? It might decide to blow up the wells, in pursuit of devout poverty and to punish the West for its corruption. An indefinite cessation of production from what is now Saudi Arabia is not something the West could take in its stride, with or without flexible markets. And going to war for the oil might not be straightforward, especially if one postulates nuclear arms in the possession of such a state.

So what should the West do? It would be hard to exaggerate the costs of a spare-no-expense dash to reduce consumption of oil. Wasting hundreds of billions of dollars to little effect would be easy; the green favourite of investing in alternative energy would do nothing to reduce oil dependence in transport, where it is most critical. It is also a woeful error to think that anti-western sentiment in the Middle East would be assuaged by radical economic disengagement: plunging the region deeper into poverty might well achieve the opposite. But the prospect of increasing dependence on Middle Eastern oil, together with the risk that people as dangerous as the Taliban could come to power there, does add to the case for some measures to reduce western demand for oil.

One measure in particular. On environmental grounds, never mind energy security, America taxes gasoline too lightly. Better than a one-off increase, a politically more feasible idea and desirable in its own terms would be a long-term plan to shift taxes from incomes to emissions of carbon. This would spur development of new transport technologies—vital in curbing the demand for oil. It would also improve the chances that OPEC's reserves will fetch a better price tomorrow than in 2020: an insight that would curb the cartel's market power from day one. Gradualism is the key to doing this intelligently. The time to start is now.

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Pensions in America

The merits of diversity

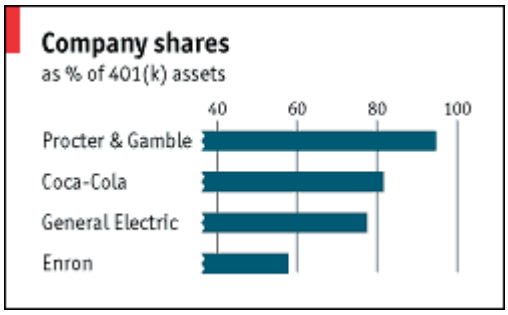
Dec 13th 2001
From The Economist print edition

A company pension plan should not be allowed to invest heavily in its own shares

Get article background

DIVERSIFICATION is one of the first rules of any investment strategy. Put too many eggs in one basket, goes the proverb, and you risk losing the lot if things go wrong. Enron's bankruptcy was bad for investors. But for Enron's employees, the bulk of whose retirement savings were in Enron shares, it was a disaster—and one that must be avoided in future.

What is most disturbing is how widespread the practice is in America. As pension funds based on employees' final salaries ("defined benefits") wither away, so-called 401(k) plans are becoming the most common company retirement vehicle. In such "defined-contribution" schemes, employees' ultimate pensions depend entirely on the investment performance of the plans. Yet such blue-chip companies as Coca-Cola, General Electric and McDonald's all have three-quarters or more of their 401(k) plans invested in their own equity. For Procter & Gamble, normally a paragon of best corporate practice, the proportion is almost 95%. Set against these examples, Enron's 58% looks almost reasonable (see article).



How has this come about? Part of the answer is that section 401(k) plans evolved out of previous schemes to encourage employee stock ownership. But there are two other, more questionable explanations. Many companies match employees' contributions to 401(k) plans in the form of company shares, not cash. In some plans (including Enron's), these come with the restriction that the shares cannot be sold until the employee is over 50. The second explanation is that companies offer their staff a relatively small menu of possible investments for their 401(k) plans, one of which is the company's own shares. Many select this option.

And why not? Nobody is being forced to put his money into a company's shares, after all. Employees of such firms as Microsoft and Wal-Mart have been able to benefit mightily from their growth through share ownership. In general, greater employee share ownership is a healthy way of giving staff more of a stake in their company's success. If lots of workers freely choose to invest their 401(k) plans in the company's shares, even if that offends against portfolio theory, should the government protect them against their own folly?

Yes, it should, for the choice is not as free as it looks. Quite apart from the company's contribution, many managers encourage staff, implicitly if not explicitly, to put their 401(k) money into the company's shares; and they discourage selling. The pressure may intensify if the company's finances are dodgy. The consequences can be severe. Many Enron workers have lost their jobs and their retirement savings in one blow. Worse, thanks to an administrative change that the company made in October, no 401(k) holders, even those over 50, were allowed to sell any Enron shares over a crucial four-week period during which the price fell by over two-thirds.

The simplest remedy would be to legislate that no more than, say, 10% of a 401(k) plan may be invested in a company's own shares. That would replicate the limit set for defined-benefit pension schemes. Several congressional bills to this effect are already being drawn up. The argument for early action is not just to avoid future Enrons, either. Most ideas for reforming Social Security involve its partial privatisation, with beneficiaries investing directly in the markets (see article). If these plans are not to be

discredited before they are even tried, Congress should act now to limit the investment of workers' retirement money in their company's shares.

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Arms control

Bush's hang-ups

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Not all arms-control agreements are worth having. But some are

IF DIPLOMACY, too, is the art of the possible, America's arms-control diplomats no longer chance their skills very far. Even before the recent anthrax attacks, George Bush singled out weapons of mass destruction as the greatest threat to America's security. He justifies “moving beyond” the cold-war Anti-Ballistic Missile (ABM) treaty with Russia—he is ready to give the required six months' notice of withdrawal—by the need for defence against smaller, less predictable new threats from North Korea or Iraq. So why has he allowed his diplomats to derail the efforts to strengthen the ban on biological weapons?

Officials, including America's, have been working for several years on an inspection regime to back up the Biological and Toxin Weapons Convention. The one being proposed had its flaws. America, with legitimate worries that biological defences or valuable commercial information could be compromised, had already rejected it. The other signatories, mindful of the new bio-terrorism threat, had wanted to keep these and other ban-bolstering proposals (including America's) on the table to see if the flaws could be fixed. But last week America single-handedly blocked the lot. Alongside Mr Bush's refusal to ratify the Comprehensive Test-Ban Treaty, and his moves to scrap the ABM treaty, this was more than an undiplomatic blunder. It seems to represent a dangerously ideological aversion to any sort of binding arms control.

Mr Bush is right to take a radical look at America's arms-control commitments in a dangerous world. Yet the test of any treaty or policy should be a practical one: whether or not it enhances stability and security. Mr Bush has a case that the 1972 ABM treaty “written in a different era, for a different enemy” now fails that test. Yet whatever happens next—whether the treaty is amended, replaced by some new understanding with Russia or just scrapped—the same stability-preserving test should apply. Announcing America's intention to withdraw increases the pressure on Russia to reach a new understanding. Scrapping the treaty without one could yet set off a new arms race, undermining security all round.

It may help to clinch a broader missile-defence deal with Russia that, after years of failing to cut a single extra bomber or missile, Mr Bush and Vladimir Putin have agreed to parallel, unilateral arms cuts. Treaty-averse Mr Bush wanted to settle it all on a handshake. Mr Putin wants something in writing: without agreed monitoring rules to show what the other party is doing with its surplus weapons, the deal could easily come unstuck. The two are now hoping to reach a compromise before Mr Bush goes to Russia in a few months' time.

To some of his more ideologically-blinkered diplomats, however, no deal with Russia is worth even that much flexibility. Others put their objections differently. Friends, they argue, have no need of legally-binding anti-proliferation agreements. Adversaries, by contrast, will inevitably cheat on their commitments, thus creating a false sense of security.

Yet the legal norms embodied in such agreements give everyone the right to know what others are up to, and to act when rules are broken. Saddam Hussein ran rings round the old rules of the Nuclear Non-Proliferation Treaty, but a determination to put that right led to UN special inspections in Iraq, the discovery of North Korea's plutonium dabbling, and new safeguards to make cheating far harder. The same agreed rules enabled South Africa, Argentina and Brazil to renounce convincingly their nuclear-weapons programmes—just as the Chemical Weapons Convention has provided a framework in which India, South Korea, Iran and others could declare and dismantle long-hidden chemical-warfare

programmes.

Walking away gets you nowhere

Biological programmes are certainly the hardest to monitor reliably, but that should be a reason to try harder, not back away, as America has just done. Mr Bush rejects the test-ban treaty on similar grounds. Yet, oddly, he continues to help pay for its monitoring regime—a recognition that the treaty's sensor system will be a lot better than anything America can field on its own—while stopping cash for on-site inspections, the best tool for investigating suspicious activity.

Pressed about their aversion to new international rules of this sort, Bush officials insist that they still support the biological ban and are still observing the test ban, and that others should too. But if those who want the rules kept won't back them up, why should those ready to break them pay heed?

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The European Union's summit

Towards a bigger, simpler Europe

Dec 13th 2001
From The Economist print edition

The European Union must make its purpose plainer

ONE of the most bizarre claims recently put forward by a clutch of European grandees is that the European Union is running out of steam and needs a majestic new "project" to give it back its purpose and puff. Nothing could be further from the truth. The EU is on the verge of bringing two of its most ambitious plans to fruition. First, in less than three weeks some of the world's oldest coinages will give way to a new currency that will serve some 300m people in all but three of the EU's 15 countries. Second, it is now probable, though not quite certain, that another ten countries will join the club within two or three years, increasing the EU's area by a quarter and its population by a fifth. On no account should the Union now embark on yet another supranational extravaganza. Rather, the period between these two huge steps should be one of consolidation and clarification. The summit this weekend in the Brussels suburb of Laeken should be about making sense of the treaties and projects already under way, not about inventing new ones.

This is all the more necessary because many of those knocking on the door are becoming nervous and confused about the nature of the Union. Part of their apprehension stems from a fear that, having sloughed off one (Soviet) yoke that mocked their national identities, they may have another foisted on them. They do not welcome the prospect of an ever-integrating superstate, whose future powers are unknown.

So the biggest task at Laeken is for the governments of the EU's 15 existing members to spell out a "charter of competences". The name may elicit groans, but there is a real need to identify which areas of policy should stay within the domain of individual countries and which should come under the collective writ of the EU. There is also a need to outline the contours of a constitution for the EU so that all its members, existing and soon-to-be-inducted, know what they are in for.

It should be reiterated, at the outset, that the core of the Union must be the all-adhesive regime that sets rules for a single market, ensuring a free flow of people, goods, services and capital. The question is how much other policies should come under the EU's control, and in what form. Some that have hitherto fallen under the sole sway of governments—asylum and immigration, for instance, and, more recently, counter-terrorism—might sensibly be brought under the EU's aegis. Others that have been under the common grip—the subsidising of farmers, for instance, which has massively skewed the EU's budget—should gradually be repatriated to national governments. But Germany's current effort to let its states bail out ailing industries should be resisted because that risks undermining the single market.

One menu for all, with side-orders

It is perfectly sensible for the EU to seek to forge a consensus in foreign policy and defence, and to back it with a European rapid-reaction force—though that is still very far from being a reality, not least because Europeans still spend too little on defence. But the EU is a hybrid, and none the worse for being so. It must do some things within a straitjacket of rules and procedures, with more issues decided by majority voting as newcomers crowd in. Others, however, will be better left to governments, albeit working together in the Council of Ministers. The EU may have its own inner clubs—for the single currency, for defence (some countries may reasonably wish to hang on to their traditions of neutrality), for a completely border-free zone under the Schengen accord, and so on. That is fine, but it does not mean that newcomers can pick which rules to obey *à la carte* as they join. Italy's suggestion that it

should opt out of current EU plans for a Euro-warrant has rightly been rejected.

Those who fear that a constitution would mean a superstate and with it the end of national independence should calm down. A good constitution would limit and separate powers as much as it would push the writ of the EU into the nooks and crannies of national life. It would also make no mention of “ever closer union” as an objective. And to make quite sure that the drafters had not got above themselves, the document should be ratified nationally by all those who will live under it, including those in the applicant countries, whose governments should play a full part in writing it.

For sure, the EU is more than just a free-trade area, as some people, especially in Britain, would wish. But that does not mean it is necessarily the embryo of a superstate, as believers in full-blooded integration clearly still hope. It is an arrangement of countries, the like of which has never been seen before, whose shape and purpose have been adapted to changing circumstances with remarkable ingenuity. The chief aim at Laeken should be to set in motion a process of constitutional clarification, so that new members as well as old can understand the aims and obligations of their club, and thereby win for it greater support from its citizens.

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Race in Britain

A diverting argument

Dec 13th 2001
From The Economist print edition

Britain has problems with its racial minorities, and the government is in danger of making them worse

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Reuters

BEWARE the man who seeks “to unify our country against the racists, against the dividers, against criminals and exploiters”. He's usually a third-world dictator preparing to execute a few individuals to divert attention from a general evil. So why is David Blunkett, Britain's home secretary, trying to rally Britons against chimeric enemies? For rather similar reasons.

In the week which saw the publication of reports by the government and three independent panels on riots between Asian and white youths this summer, Mr Blunkett launched a debate about race. Immigrants, he said, should learn British “norms of acceptability”, whatever they might be. The main riots report echoed him, recommending that immigrants pledge an oath of allegiance to the nation.

A passionate argument has ensued. Some brown people are cross because they reckon they are being fingered as disloyal. Some white people are cross because they reckon immigrants should show some sort of commitment to their new country. The debate has clarified nothing, but has served a useful purpose for the government, in diverting attention from the serious issues at stake.

It's the economy

There is nothing very dreadful about the idea of requiring people to learn a bit of history and language and formalise their citizenship of a country. All other rich countries do it. Britain is oddly casual about what should be an important step in people's lives. But all this, like the dictator's executions, is beside the point.

There are two reasons why people are currently worked up about issues of race, nationality and loyalty. One is the rioting. The other is the handful of British Muslims who publicly expressed their sympathy for Osama bin Laden in the wake of the September 11th attacks. But the measures being debated will do nothing to mitigate either of these problems.

It is not very comfortable to know that there are British Muslims who sympathise with Mr bin Laden, but there is nothing to be done about it. No government-sponsored night-classes in the virtues of liberal democracy are likely to change their minds. Indeed, it is central to British “norms of acceptability” that they should be left to their foolishness.

There is, by contrast, something to be done about Britain's northern cities, but that something has nothing to do with inculcating people with British values. Two big things have gone wrong with some of these places: segregation and poverty. If the government prefers not to discuss these matters, that is understandable, because its policies are likely to make the first worse, and will struggle to have much impact on the second.

Segregation starts at school. Some of the schools in those northern towns are close to 100% Asian. Such problems can be fixed, by adjusting school catchment areas or—dread word—busing. But the

government's policy of allocating more of the education budget to single-faith schools, which this paper has already fulminated against, threatens to make that problem worse. Christians will be educated in one school, Muslims in another, and never the twain shall meet.

The government's anti-poverty efforts are at least not regressive; and some of its labour-market measures have helped. But unemployment blackspots in Britain remain a huge social problem, worse than in other rich European countries (see article). In some of the areas where disturbances took place, more than a third of the population is out of work; and the problem is not confined to Asian areas. These deep geographical divides persist for many reasons—an economy overcentralised in London, a social housing system that makes moving difficult, nationally-negotiated wages which discourage the growth of jobs in poor areas, among others—some of which, at least, governments can address.

Jobs and schools are what matter most to people. They, not “norms of acceptability”, are the sorts of values that Britain should be talking about.

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Letters

Dec 13th 2001
From The Economist print edition

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Tax and smoke

SIR – You mistakenly imply that Arizona does not spend sufficient funds on tobacco education and control ("Saved by smokers", November 24th). On the contrary, in 1994 Arizona's voters passed a proposition, similar to the one you mention in California, that raised cigarette taxes and used the revenue to fund a successful comprehensive tobacco education and control programme. Since 1996, this programme has resulted in a 22.6% decrease in adult smokers, a 23.3% fall in high-school smoking and a 39% drop in middle-school smoking. As Arizona had committed to funding this programme before the tobacco settlement agreement was signed, voters rightly decided to use the agreement funds for other health-related purposes.

Sadly, the governor and state legislature have recently threatened to raid the revenues generated by the tobacco tax but the fact remains that Arizona is one of only seven states that spend at or above the level recommended by the national Centres for Disease Control and Prevention.

Janet Napolitano
Arizona attorney-general
Phoenix

SIR – You are right that smokers are model citizens: we lead productive lives, making Social Security contributions, and with exquisite courtesy drop dead just prior to retirement age. This altruism is all the more remarkable because, during our brief lives, though they be as the flight of the swallow through the mead hall, we are exiled from office buildings, airports and the houses of friends, and are regularly disdained by our betters for our "use" of tobacco.

You ask how the medical costs of my generation's addicts are going to be funded now that the states are spending their tobacco-suit windfalls with the usual visionary farsightedness of governments. The answer: when the money is needed, another cash-rich target of opportunity will be identified and then convicted in the yahoo-courts of public opinion and the appointment-bought courts of the judiciary. Or, hell, we'll just run another daily lottery.

Chuck Keelan
Dumont, New Jersey

Voice unsilenced

SIR – Your reference to the Voice of America requires both clarification and correction ("Relaunching the propaganda war", November 10th). While the audience share for VOA's Arabic-language broadcasts is indeed around 2%, the picture is quite different in Afghanistan. According to research conducted in 1999, some 80% of Afghan males (we were unable to interview females) tune in to our Pushtu and Dari broadcasts at least once a week, and 67% listen every day.

Regarding the statement that "VOA had closed most of its services in Afghan languages and only recently started them again", we have been broadcasting continuously in Dari and Pushtu to Afghanistan since 1980 and 1982 respectively.

Joe O'Connell

Director
Office of External Affairs
Voice of America
Washington, DC

On the Rock

SIR – How could Gibraltarians be for any discussion that might change their status("Will the rock be rolled over?", November 17th)? Let readers imagine that they themselves are made an offer of much lower taxes, but the same public services and a secure source of financial resources seeking laundering. Gibraltarians use Spanish roads and beaches only hundreds of metres away from them, and even land—not included in the Utrecht treaty—for their airport. And it is free.

For Spain this issue may be, in a limited and partial way, a question of pride, but it is mostly common sense. How can Spain bear that this little relic of the past should interfere in its air-space control and security policies while attracting criminal organisations that use it as a tax haven?

Javier Blazquez
Madrid

SIR – Gibraltar was never "Spanish"; it has always been Iberian, geographically, and remains so. Voltaire's "The Age of Louis XIV" gives an entertaining account of the facts. As he says, on August 4th 1704 a few British sailors "who were out merrymaking" approached in their rowing boats and took possession of the place. The event was peaceful and there was no other lawful ruler of the territory: a clutter of European royalty was arguing about the matter but the various provinces of Iberia were then separately ruled (or not). Philip, Duke of Anjou conquered them after 1704. Gibraltar has never been Spain's territory.

John Gibson
Harrow, Middlesex

Chile's copper

SIR – You pinpoint dependence on copper as an important weakness in Chile's economy ("In search of new tricks", December 1st). You suggest selling Codelco and quote me as saying, "better to start by selling a minority stake." This misrepresents what I said. I explicitly stated that as long as the company is efficiently managed and does not require new equity to finance its expansion, it is in the interest of Chile to maintain Codelco as a fully state-owned company.

There are strong arguments in favour of special taxes where economic rents exist, as is usually the case with non-renewable resources. Codelco has to be seen as the vehicle through which the country at large captures a share of the rent from the exploitation of its copper reserves. This is the economic rationale behind the decision not to privatise Codelco and behind our business plan aimed at doubling the value of the company by 2006, while transferring the whole of its profits to the Treasury. Capital expenditures will be funded by internally generated funds (depreciation and other allowances), sale of non-core assets, partnerships and debt. No additional equity will be required.

Copper is one of Chile's important comparative advantages and will remain an important player in our economy. To argue that selling Codelco is "a more direct way of reducing Chile's exposure to copper" not only misses the point, it is a mistake. How could the change in property—from the state to private investors—reduce the degree of dependence on copper? If anything, it may create a new form of dependence, depending on who is the buyer. The challenge is to make the best use of copper for the benefit of present and future generations. This calls for capturing at least part of the economic rents copper generates and investing them in human capital through education and training. Codelco is the vehicle Chile has decided to use to capture the major part of those rents.

Juan Villarzu
President and chief executive
Codelco-Chile
Santiago

Bargain property?

SIR – When discussing British Telecom's sale of commercial property to Telereal, you claim that the deal is for £2.38m and that it is the largest of its kind to date in Britain (World this week, December 1st). If both statements are correct, the next time I am in London I will look to rent an office to sleep in rather than a hotel room. Or perhaps you mean billion?

John Naud
San Francisco

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Fighting terrorism

A peace to keep?

Dec 13th 2001
From The Economist print edition

AP

Securing order in Afghanistan is essential. But, for outsiders, the risks are huge

THERE is, as Tony Blair pointed out this week, an “immense amount of detail” to be settled before a multinational but British-led security force can be deployed in Afghanistan. And there is little time for such fine-tuning to be done. A multi-ethnic government is supposed to start leading the country towards a brave new future—free of the closely related scourges of internecine war, drug-smuggling and extreme poverty—on December 22nd. And the regime's chances of holding together will be greatly influenced by the amount of international support, military as well as economic, that it receives.

Moreover, several of the open questions about the future role of foreign soldiers in Afghanistan are not just matters of detail. Will they be peacekeepers, peace-enforcers, guarantors of humanitarian aid or (as seems most likely) an uneasy mixture of all three? Will they be deployed only in Kabul, as suggested after this month's Bonn agreement on Afghanistan's political future? Or will they fan out into battered cities like Mazar-i-Sharif, Herat and, above all, Kandahar—the spiritual capital of the disgraced Taliban regime, and the last place it abandoned?

A long list of “mistakes to be avoided” by international peacekeeping efforts was compiled after the fiascos of the 1990s. These included an initially altruistic mission to starving Somalia which ended, for the American contingent, in a hasty withdrawal after losing 18 soldiers in a day. Then came the UN force in Bosnia, pig-in-the-middle of an unresolved ethnic war, which could carry out its humanitarian tasks only by dint of humiliating concessions to some unspeakable local warlords.

Among the conclusions which security pundits drew was that peacekeeping can be worse than useless in situations where there is no peace to keep; and that apparently “neutral” missions, such as the distribution of emergency aid, can easily be hijacked by warring parties, especially when no single authority controls the terrain. If the outside powers with an interest in Afghanistan were going by the book, they would probably steer clear of peacekeeping there.

The American-led war effort against the remnants of the Taliban regime and the al-Qaeda fighters that it protected has gone well, but is by no means finished. By midweek, American aircraft were still pounding al-Qaeda's presumed hideouts in the eastern Afghan mountains, even as a local anti-Taliban commander was negotiating surrender terms. Some of the mainly Arab al-Qaeda fighters seemed keen to lay down their arms, and at one point they promised to turn themselves in early on the morning of December 12th; but the bombing resumed after the surrender failed to materialise.

Four days earlier, the Americans had dropped a 6,800-kilogram “daisy-cutter” bomb—one of the most

formidable conventional munitions in the Pentagon's arsenal—on the caves where some of the al-Qaeda leadership, possibly including Osama bin Laden, the network's ultimate boss, were thought to be holed up. The bomb, said American officials afterwards, had the “desired effect” of killing a great many fighters. It has not touched Mr bin Laden who, according to various reports, was either still fighting to the death or had safely escaped to Pakistan.

But the Bush administration was eager to counter any idea that its foes were a spent force. For one thing, said Donald Rumsfeld, the defence secretary, the commendable efforts by Pakistan's forces to block escape routes out of Afghanistan might prove insufficient: “There's no way you can put a perfect cork in the bottle.” He also stressed that, as the area controlled by the Taliban and al-Qaeda forces grew smaller, the danger to the American-backed coalition would grow greater. His deputy, Paul Wolfowitz, was equally cautious, saying that it would be “a long and difficult job” to root out Taliban and al-Qaeda fighters still at large.

“There's no way you can put a perfect cork in the bottle,” said Donald Rumsfeld of the Pakistan-Afghanistan border

Hamid Karzai, a Pushtun tribal leader and military commander, arrived in Kabul on December 12th to take the reins of government, having more or less finished his military jobs in Kandahar. At present, power is wielded in the capital by the Northern Alliance of Tajiks and Uzbeks, whose sentiment towards a multinational force is lukewarm, to say the least. Burhanuddin Rabbani, the alliance leader who grudgingly promised to renounce his claims to the Afghan presidency as part of the Bonn accord, described the forthcoming multi-ethnic government as an arrangement imposed by outside powers. “We hope this will be the last time that foreign countries interfere in Afghanistan's affairs,” he said sourly.

The three senior Tajiks who will serve under Mr Karzai also seem unenthusiastic. Mohammed Fahim, the commander who expects to be confirmed as defence minister, says the outside force should number no more than 1,000 and have a “very limited” role. In fact, the force western governments have suggested would be much larger. Britain is offering to provide the bulk of the first contingent, with its air assault brigade (bristling with attack and support helicopters) and a mobile brigade headquarters. It does not, however, want to lead the force for more than six months. The first arrivals, possibly about 2,000 strong, will evolve into a much larger force, including troops from France, Germany, pro-western Muslim countries such as Turkey, Jordan and Indonesia, and even Russia, if it can overcome its fear of Afghan quagmires. Rudolf Scharping, Germany's defence minister, said at least 8,000 troops were needed, and called for a robust mandate from the United Nations—though the UN will not be in charge. Nobody quite knows how the force will interact with the American troops who may still be fighting on December 22nd.

Lakhdar Brahimi, the UN envoy to Afghanistan and chief broker of the Bonn accord, has been shuttling between Pakistan and Afghanistan, trying to sell the virtues of an internationally policed and financed peace settlement. “The force, if and when it comes, will come as a friend, not an enemy,” he said in Kabul this week.

There is clearly a danger that, if agreement cannot be reached on an externally-aided rescue programme for Afghanistan, the country faces more fratricide and even worse horrors for its refugees. It is also true that any peacekeeping mission is likely to face military challenges. Peacekeeping in post-war Bosnia and Kosovo has turned out, on balance, to be somewhat easier and more worthwhile than some people had expected. But with barely a week to go before the new government is supposed to take power in Kabul, and with full-scale war still going on in places, it is still an open question whether peacekeeping in Afghanistan is a risk worth taking.

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Russia and Afghanistan

All smiles, for now

Dec 13th 2001 | MOSCOW
From The Economist print edition

Gingerly, Russia is returning

DECLARE victory and stay at home. That, at first sight, sums up Russia's policy in Afghanistan. The caution is understandable: Russians regard the Soviet Union's ten-year war there rather as Americans remember Vietnam.

So far, Russia has firmly refused to send troops to fight the Taliban or to keep the peace. It played no significant role in the Bonn peace talks, though it praised the outcome. “The decisions made in Bonn are—excuse my immodesty—a mirror reflection of our position,” said Russia's hawkish defence minister, Sergei Ivanov, last week.

Russia's first problem is that Afghanistan (unlike Vietnam for America) is too close and too dangerous to ignore. It borders on three former Soviet republics: Turkmenistan, Uzbekistan and Tajikistan. All three are badly governed and potentially unstable. At home, Russia has its own problems with extremist Islam of the kind that flourished under the Taliban.

Reuters

What does he want, exactly?

So far, the war has gone as Russia wanted. Several big pitfalls have been avoided. America has not—yet—attacked Iraq. The Taliban collapsed pretty neatly, and the new interim government includes nobody Russia really objects to. The chief ministries are held by members of the Northern Alliance, which Russia has financed and armed in past years.

Domestic opposition to Russia's stunning foreign-policy *volte face* that helped American troops to get into Central Asia has been muted and ineffective. President Vladimir Putin has been able to portray Russia as a trustworthy and useful ally, and the American gratitude thus won will ease future talks with the West about trade, security and finance. The Taliban's defeat also lets the Central Asian regimes breathe more freely, at least for a while. The most-feared Islamic guerrilla, Juma Namangani, who led insurgents in Uzbekistan, is reported to have been killed in Afghanistan.

The next question for Russia is how to improve its standing in a country where local memories are still bitter, and its own muscles wasted. For now, that means relief work. Despite the colossal suffering inflicted on Afghanistan during the Soviet war in the 1980s, this is not as daunting a task as it might sound. Urban and educated Afghans look back on the Soviet-backed regime as at least less bad than the chaos and bigotry that followed it. Older Afghans have genuinely warm memories of the Russian aid that used to flow into the country in the 1960s and 1970s. That included building the highest tunnel in the world, under the Salang pass. Russia is now going to mend the tunnel, damaged in 1992, and will help to clear mines. It has set up a field hospital in Kabul.

In the longer run, however, Russia has its own interests in the region. The biggest of these is keeping a large say in how the energy reserves of Central Asia reach world markets. Given a stable Afghanistan, ambitious plans for gas and oil pipelines will look more practical. Russia currently benefits hugely from the stranglehold created by the Soviet-era pipeline system, particularly over Turkmenistan, which can sell its plentiful gas only to Russia at artificially low prices.

A danger exists that, if trouble breaks out again, Russia will start meddling in internal Afghan politics, supplying favoured commanders with arms and cash. Not everything has gone swimmingly, even in recent weeks. Russia has supported the Northern Alliance more firmly than America would have liked, for example in its unexpected advance to Kabul. Soon afterwards, the speed with which Russia deployed its own large armed aid mission in the Afghan capital, through Bagram airport, left some westerners very

annoyed.

Yet the American secretary of state, Colin Powell, was eager to smooth over that difficulty when he visited Moscow this week. He said it had been an “an honour and a pleasure” to help Russia use the airport. All smiles, then, for now.

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Oil

A dangerous addiction

Dec 13th 2001
From The Economist print edition

The world is increasingly dependent on Middle Eastern oil. After September 11th, this could be cause for increased alarm—or just common sense

HOW much is a barrel of oil worth? In the Middle East, reserves can cost barely a dollar to lift out of the ground. Add a decent profit margin, and you still have an exceedingly modest price. Yet quite a bit of the world's oil comes from far more expensive places. Last year, the price averaged $27 a barrel.

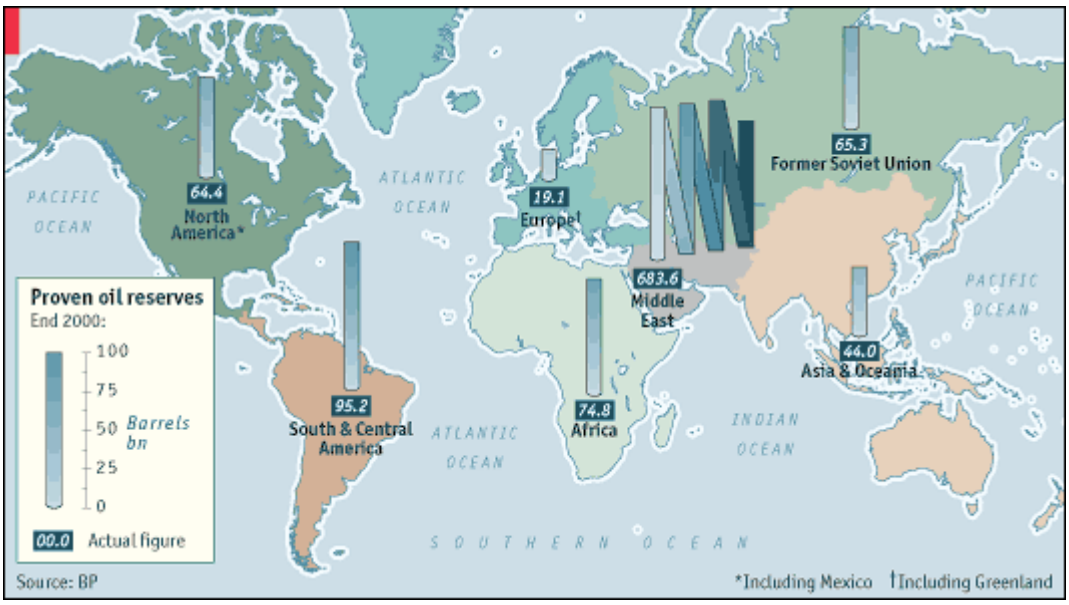
It is not geology that determines the oil price, however, still less the free interplay of supply and demand. Mostly, it is the whims of the Organisation of Petroleum Exporting Countries (OPEC), the ill-disciplined cartel led by Saudi Arabia. Small wonder, then, that the price of oil has yo-yoed in the past three years. Prices have recently plunged to below $17 a barrel as an anaemic world economy and a stand-off between OPEC and Russia, the biggest non-cartel exporter, pushed the oil market to the brink of short-term collapse.

Only Osama bin Laden, it seems, can give you a fixed price for a barrel of oil. He makes it $144. Several years ago, the leader of the al-Qaeda terrorists issued a little-noticed proclamation on energy economics. In it, he accused the United States of “the biggest theft in history” for using its military presence in Saudi Arabia to keep oil prices down. In his view, that larceny adds up to $36 trillion. America, he insisted, now owes each Muslim in the world around $30,000, and still counting.

After September 11th, energy-security experts have Mr bin Laden, his sympathisers and terrorists in general very much in mind. America used to assume that, if a hostile group or regime took over the Middle Eastern oilfields, it would send in its troops to quash the troublemakers and protect the oil. Now those terrorists may have nuclear weapons that they could turn either against America or against the oilfields themselves.

Yet the real cause for worry, a related one, is much longer-term. Because the world remains so dependent on oil for transport, it cannot stand any disruption in supplies. And there is a strong possibility of such a supply-shock at some time in the next few decades. How will the United States cope with this?

In too few hands



Oil is not scarce. Enough lies underground to keep the world's motors humming for several decades yet. The snag is that the lion's share of it—and almost all the oil that is cheap to extract—lies under the desert sands of a handful of countries around the Persian Gulf (see map).

Today, Saudi Arabia alone sits on a quarter of the world's proven oil reserves, and four of its neighbours can boast about a tenth each. Because the Saudis choose not to produce as much oil as they could, OPEC's share of world oil exports is only about 40%: influential, but not enough to control prices completely. As the world continues to deplete non-OPEC oil, however, that share will increase dramatically—and with it, the market power of those Middle Eastern regimes. All the more likely, then, that supplies may be disrupted. This threat is particularly acute for the United States, which is both the biggest oil-guzzler and the de facto guarantor of oil supplies for its allies.

The Saudis, unsurprisingly, deny that a shock is in prospect at all. Oil is “a global market,” said Ali al-Naimi, the oil minister, two years ago. “Those who propagate the issue of supply insecurity, dangers of import dependence and perceived instability of the Arabian Gulf are ignoring realities.” He pointed out that his country intentionally maintains a cushion of excess capacity against any disruption of supply. It was his country's buffer, not any non-OPEC production, he noted, that came to the rescue during the Iranian revolution, the Iran-Iraq war and the Gulf war.

All this is true, but what if the Saudi regime were overthrown by some rabidly anti-western band? Not to worry, argues John Browne, chairman of BP: “However fundamentalist, a regime still needs money to look after its people.” His sentiment is echoed by many economists, who insist that oil is a “fungible” commodity that is worthless unless it gets to market. In the long term, that is doubtless true. But even short-term disruptions can wreak havoc on the world economy: when the Iranian revolutionaries booted out the shah, Iran's oil exports collapsed. And some future revolutionaries may choose to forgo oil revenues and live in poverty to punish the West.

Donald Losman, in a provocative paper published by the Cato Institute, a libertarian think-tank, goes further. He argues, with some justification, that the pain associated with previous oil shocks had more to do with foolish policy responses by western governments meddling in the market than with disruptions to supply. He calculates that America wastes $30 billion-60 billion a year safeguarding Middle Eastern oil supplies even though its imports from that region totalled only about $10 billion a year during the 1990s. He also observes that semiconductors, the backbone of the digital economy, come mostly from one place (Taiwan), but American soldiers do not guard chip plants.

Oil's uniqueness

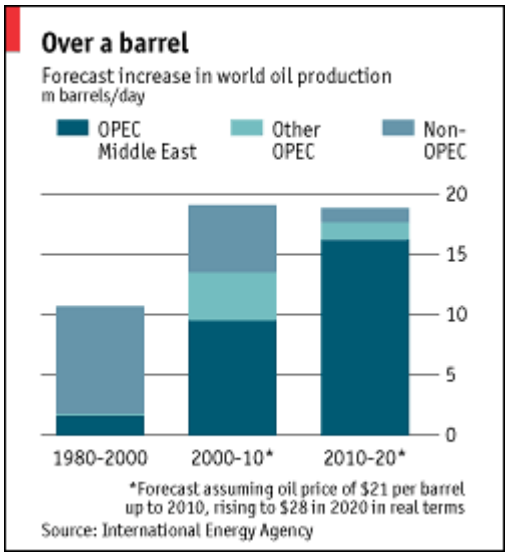
Yet semiconductors and oil are not at all the same. The American economy could manage without new semiconductors for some time, but it would grind to a painful halt the moment oil dried up. Semiconductor plants can also be built anywhere, but oil is found only in certain spots. The petrol riots in Britain in the autumn of 2000 showed how easily a modern economy can be brought to its knees when its oil supplies are disrupted.

If oil is essential, then, why not simply boost non-OPEC supplies? President Bush, extolling America's “energy independence”, has been trying to push a bill through Congress that would open part of the Arctic National Wildlife Refuge in Alaska to oil-drilling. But America consumes so much that all the oil in Alaska would not dent its reliance on the imported stuff.

The dramatic wave of non-OPEC discoveries in the 1960s and 1970s in the North Sea, Alaska and other places has helped to counterbalance OPEC's pricing power. But these big fields are about to enter a phase of rapid decline. Part of the explanation is simple old age. In the North Sea, for example, most large fields are now 70-90% depleted. And the dramatic techniques that have allowed big oil companies to improve oil-recovery rates have ended up draining fields all the faster.

Harry Longwell, a top manager at ExxonMobil, insists that a new wave of non-OPEC development, from the Caspian to the deep waters of the Gulf of Mexico, is technically feasible. However, he says that it will require “huge new investments”. How much? The International Energy Agency reckons big oil firms will have to invest a whopping $1 trillion upstream over the next decade. Developing non-conventional hydrocarbons, such as Canada's tar sands, would prove even more expensive. Such stuff would also take much longer to bring to market, and so prove less valuable as a buffer stock. In other words, the real concern is not the scarcity of hydrocarbons, but the ever-higher cost and commercial risk of finding non-OPEC reserves—especially since price volatility discourages investment.

Now here's the rub: even accepting in full the oil industry's optimistic assessment that it can meet this challenge, the “call on OPEC” will still increase dramatically over the next 20 years (see chart). In order to meet the world's unchecked thirst for oil, forecasters are assuming (perhaps praying is a better word) that Saudi Arabia and its neighbours will invest the vast sums needed to expand output. If they do not, it will be the world's consumers who will pay the price.



Saving and conserving

What can be done? Unfortunately, petroleum has a near-monopoly grip on transport. The best thing governments can do is to buy some insurance against politically inspired supply disruptions, and the panics and hoarding that go with them, by greatly expanding buffer stocks of oil.

This is all the more urgent because structural changes in the oil industry (mega-mergers, cost-cutting and a move to just-in-time inventories) mean that privately held reserves have fallen steeply from their levels in the 1970s. Add to this the official neglect of government stockpiles, and you get a world that is needlessly vulnerable to the next oil shock.

Mr Bush has now begun to rebuild America's Strategic Petroleum Reserve. Conservation, too, after years of sneers, is firmly on the American political agenda. Yet even conservation has drawbacks: it may simply mean less mobility and less trade. The better way forward is to promote energy efficiency. The United States now imports about 11m barrels of oil per day (bpd), around a seventh of the world's total production. Philip Verleger, an energy economist, reckons that the figure would be only 5m or 6m bpd if America had made a serious effort to improve fuel efficiency after the previous shocks.

One efficiency measure under debate is the strengthening of the Corporate Average Fuel Economy (CAFE) laws: raising them for cars, and closing the loophole that allows light trucks and sport-utility vehicles to use more petrol. A study done by America's National Academy of Sciences (NAS) earlier this year was certain that, with technologies that are readily available, reductions in fuel use of up to 20% could be achieved comfortably. Some vehicles could achieve a 50% increase in fuel economy—and more if radical new technologies, such as fuel cells, take off.

Against shocks, taxes

However, a world powered largely by fuel cells (which combine hydrogen and oxygen to produce electricity) could be decades away, especially if all America does is tinker with fuel-efficiency standards. The best way to encourage the development of new transport fuels and technologies is through taxation that reflects the “energy security” risk (as well as dangers to health and the environment) of burning oil. Europe recognises this, and over the past decade has started to shift the burden of taxation from income to, for example, carbon emissions.

What are the chances that America too will start to tackle its petro-addiction? James Schlesinger, a former energy secretary, says he still bears the bruises from attempting to propose higher oil taxes in the past. A recent encounter on Capitol Hill suggests that times have not changed much. After the NAS panel had prepared a preliminary report, Paul Portney, its chairman, was asked to address a congressional panel. George Allen, a senator from Virginia, was plainly unhappy with the report's suggestion that fossil-fuel use could be easily curbed by tightening CAFE regulations. The visitor was asked whether there was any other way to encourage fuel efficiency without resorting to market-distorting regulations.

Why, yes, said Mr Portney: you could make a significant increase in the federal petrol tax. Mr Allen was astounded. The notion, he said, was “just flat ignorant”. Senator John Kerry, the panel's chairman, retorted in frustration, “I can see the headlines tomorrow: ‘Virginia senator calls Europeans ignorant', or maybe worse.” Mr Allen was unrepentant. The road away from dependence on OPEC and Middle Eastern oil could be long indeed.

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The economy

Don't bet on a swift recovery

Dec 13th 2001 | WASHINGTON, DC
From The Economist print edition

Why the economy will stay sluggish for longer than Wall Street thinks

AMERICA'S economic forecasters failed dismally to predict the current recession. They now seem determined not to repeat the mistake and miss the onset of recovery. In a week when the Federal Reserve fretted about continuing economic weakness and cut short-term interest rates for the 11th time this year to 1.75%—the lowest nominal level since 1961—the talk on Wall Street was whether the turnaround had already started.

Conventional wisdom among the number-crunchers is that the economy will start to grow again in the new year. The Blue Chip consensus forecast expects a 1.3% annualised fall in economic output in the last three months of 2001 and 0.4% growth in the first quarter of 2001. Share prices on Wall Street imply that investors reckon the recovery will be swifter and stronger. The Dow Jones Industrial Average is hovering around the symbolic 10,000 mark; it is up 20% from its September low, and the Nasdaq is up 40%. Bond yields have soared recently, suggesting people are even fretting about inflation.

This optimism is not entirely misplaced. A lot of recent economic news has been much less bad than many expected. Spending by America's army of consumers—the biggest contributors to overall demand—has held up remarkably well, particularly when it comes to buying cars.

Lured by zero-financing deals, Americans bought more than 21m vehicles (on an annualised basis) in October, against an average rate of 17m in the previous nine months. More surprising, they continued this binge in November, buying more than 18m. Overall retail sales fell back in November, after their car-led surge in October, but the spending rout that pessimists expected has, so far, not materialised. Economists at Goldman Sachs last week revised their estimates for real consumption growth in the fourth quarter from a fall of 3.5% to a rise of 3%.

Boosted by cheap mortgages and warm weather, the housing sector is also holding up well. House sales have rebounded, and real construction spending rose in October—the first rise in nine months. Most encouraging of all, glimmers of hope can be seen in manufacturing, which has been in decline since mid-2000. The monthly survey of purchasing managers was stronger than expected and demand for manufactured goods may be stabilising.

So there are real signs that the worst may be over. The question is whether such evidence is, as the Federal Reserve said this week, “preliminary and tentative”, or whether it points, as Wall Street seems to think, to an imminent strong recovery. Wall Street has history on its side. The American economy has a habit of rebounding strongly. Since 1945, growth of 5-7% has been common in the year following a downturn. But there are good reasons why this particular recession could end rather more sluggishly.

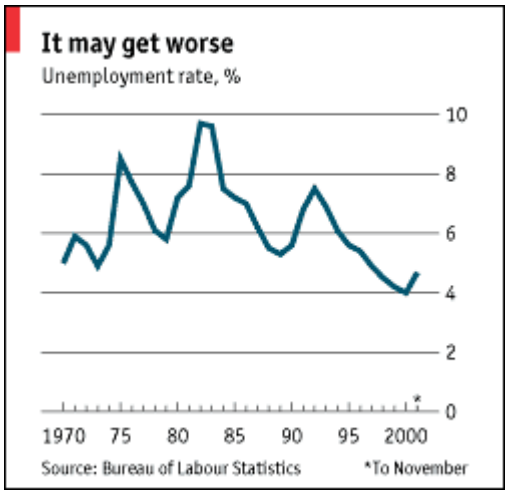
Take consumption first. In recent years the cheerful willingness of Americans to get out their credit cards at the least provocation from retailers has made fools out of pessimists. But a new surge of spending is unlikely. First, a good chunk of recent spending has simply borrowed from next year's demand. There is, after all, a limit to how many cars even an American wants.

Second, consumers have had a (well-timed) fillip from lower energy prices and warm weather. So far this year there have been more than a fifth fewer “heating degree days”—a rough indication of demand for home heating fuel. (The same warm weather has also given a boost to construction.) And energy prices

have plunged. By one estimate, this will lop about $80 billion (on an annualised basis) off household energy bills this winter. But nobody expects warm weather—or lower energy prices—to last forever.

Third, the labour market is still weakening dramatically. Unemployment rose to 5.7% in November. More than 1m Americans have lost their jobs since September 11th alone. And history suggest the jobless rate is likely to rise quite a lot further. Economists at HSBC point out that in recessions unemployment has typically risen 3.2 percentage points over an average period of 18 months. If that average holds in this downturn, the jobless rate would continue to rise until March 2002, peaking at 7.1% (ie, 1.4 percentage points higher than it is now). Higher joblessness will surely dampen consumption.

Finally, there is the perennial question of the low level of household saving. Previous recoveries have been fueled by consumers' willingness to save less. Given the low level of saving, it is at least arguable that this time consumers will be keener to stash away any extra dollars they get (including tax cuts from the government).



If these arguments point to modest consumption growth, could the engine for a vigorous recovery come from the corporate sector instead? After all, it was a collapse in investment that precipitated the downturn. And at one level, there could be a sharp turnaround. Firms have been slashing inventories: but once demand shows signs of holding up, this could change quickly.

Yet it is not easy to predict when businesspeople will feel willing to splash out on longer-term investments, such as new factories and equipment. Some analysts argue that the current aggressive house-cleaning is making room for expansion in the middle of next year: Richard Berner at Morgan Stanley, for instance, calculates that corporate America's excess capacity in technology will have nearly disappeared by then. But overall capacity utilisation rates remain weak, so it is hard to be sure about a new investment boom.

With luck, Uncle Sam will help rather than hinder the recovery. Government spending is clearly on the rise. The still-under-debate economic stimulus bill may boost things a little (though that could easily be negated by higher long-term interest rates if its tax provisions spook the bond market). With the global economy stagnant, exports are unlikely to contribute much to the recovery—though that, too, could turn around by the end of 2002.

In short, the ingredients for ending the recession certainly exist. But it is hard to see how they can be combined to produce the strong recovery that Wall Street is banking on.

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Dick Armey moves on

The end of the big right idea?

Dec 13th 2001 | WASHINGTON, DC
From The Economist print edition

The changing of the Republican guard is indicative of the party's ideological drift

AP

Armey returns to barracks

THE events of September 11th wrought many changes in America, great and small. The announced resignation this week of Dick Armey, the number two in the hierarchy of the House of Representatives, sounds like a small change, but symbolises a bigger one.

Mr Armey, the House majority leader, came to political prominence at a time when Big Ideas mattered. He wrote most of the “Contract with America”, the manifesto of Newt Gingrich's revolution, which swept the Republicans to power in 1994; and many of his beliefs—notably the merits of a flat tax—have gone from the wacky to the debatable. Mr Armey helped persuade the House not to reverse any of George Bush's tax cuts as part of the proposed post-September 11th stimulus package.

But Big Ideas about small government look odd at a time when public trust in government has tripled, and when Mr Bush shuns much of the Gingrich legacy. September 11th has also rendered incongruous the “leave-us-alone” strain of Republicanism that Mr Armey exemplifies. Osama bin Laden didn't leave America alone. He challenged the isolationist strain that occasionally surfaced in Mr Armey, who once joked that he had been to Europe and didn't need to go again. In that sense, September 11th finally ended the revolutionary strain of Republicanism.

What follows him? In personnel terms, the probable answer is Tom DeLay, the majority whip and number three in the hierarchy. Like Mr Armey, Mr DeLay is a Texas conservative (from the Houston suburbs; Mr Armey is from north Dallas). But he is much more confrontational—he is known as “the Hammer”—and would tighten the conservatives' hold on the Republican party's congressional leadership.

This is a prospect that might yet encourage moderates to run against him, touching off an intriguing battle for the direction of the party just at the time that it will be struggling to hold on to its narrow majority in the 2002 mid-term election. Mr DeLay's putative promotion would matter in another way: if he won, the party would lose his day-to-day vote-counting wizardry. He has been the most successful whip Congress has seen for a generation.

The bigger question is what follows Mr Armey ideologically, if anything. This week the House and Senate compromised on a mushy education-reform bill that drops vouchers, increases spending and boosts the federal role in educational testing. The bill shows how much the administration has parted company with the likes of Mr Armey, who wanted to abolish the Department of Education and provide vouchers for all children in Washington, DC's public schools.

That was inevitable: the Republican revolution is long gone. What is less clear is what there is to take its place, except tax cuts. In the summer it seemed that the administration had failed to define what “compassionate conservatism” meant, was running out of domestic policy ideas and needed some sort of second wind. Perhaps it still does, but there are few signs the administration is worried. In the wake of September 11th, Big Ideas about domestic policy seem to matter less and less. No wonder Mr Armey felt it time to retreat.

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Pension reform

Dust to dust

Dec 13th 2001 | WASHINGTON, DC
From The Economist print edition

A worthy commission provides an excuse to do nothing

REMEMBER George Bush's campaign pledge to push for a public-pension system based partly on private accounts? As the White House grapples with war, a recession and the prospect of several years of budget deficits, its enthusiasm for tackling something as expensive (both financially and politically) as pension reform has sagged.

Fortunately for Mr Bush, the conclusions of his Presidential Commission on Social Security Reform, released on December 11th, are unlikely to add any urgency. The commission wants a discussion period of at least one year before any legislative action is taken. More important, it offers no single road map for reform. Instead, it suggests three different “reform models”.

The simplest version allows people to invest 2% of their payroll tax contributions in individual accounts; in return their Social Security benefits would be docked by the same amount of money compounded at a real interest rate of 3.5%. Unfortunately, the commission reckons that “as yet unspecified actions” would still be required “to avert Social Security's insolvency”.

The other two sorts of personal account do more for Social Security's long-term health. One would allow a worker to invest 4% of his payroll tax contributions (up to a maximum of $1,000 a year), with the corresponding reduction in benefits compounded at a real interest rate of 2%. Overall Social Security benefits would grow more slowly, since they would be indexed to inflation rather than wages (though there would be better provision for poorer Americans). Though it would have transition costs, this option would eventually make Social Security solvent.

The third option would allow workers to invest 2.5% of their payroll taxes in individual accounts, providing they also invested 1% of their total income in the same accounts. This approach would alter Social Security's benefits in complicated ways, partly because of longer life expectancy. It would, for instance, encourage people to work longer. It also envisages new sources of tax revenue dedicated to pensions.

The commission has produced some useful technical achievements. It has shown how retirement accounts could work in practice. And it has proved which sums add up (and which do not). But it has built little political momentum for reform, and it has come under attack. The left predictably says it would reduce guaranteed benefits. The right thinks that the commission has been far too tame. But for Mr Bush the report was probably right on target: an excuse for doing nothing.

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New York's money troubles

Big red apple

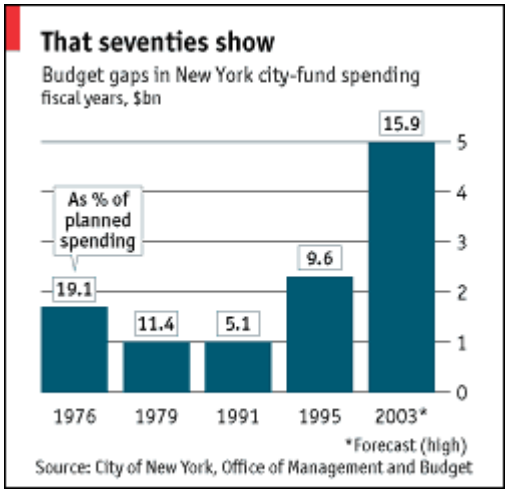
Dec 13th 2001 | NEW YORK
From The Economist print edition

The fiscal problems facing Mike Bloomberg are becoming all too clear

ONE advantage of electing a billionaire, went a joke during New York's recent mayoral election, was that he might personally bail out the city. Wisely, Michael Bloomberg, the media tycoon who will succeed Rudy Giuliani as Gotham's first citizen in January, made no such promise during his election campaign. Apart from anything else, he may not have the cash. The city's budget gap next year between spending plans and expected revenues may well exceed even the mayor's net worth of $4 billion.

A new study by the independent Citizens Budget Commission (CBC) puts next year's budget gap at $4 billion-5 billion, 13-16% of projected revenues. This is the biggest gap facing a mayor since Ed Koch inherited the mess left behind by Abraham Beame in the 1970s (see chart). Back then the deeply indebted city found itself unable to borrow in the credit markets. Part of the rescue package has required the city to balance its operating budget ever since. Any deficit of $100m or more would trigger a takeover of the city's finances by New York state, through a Financial Control Board. No mayor wants that.

The CBC reckons that between half and two-thirds of the projected budget gap has nothing to do with the costs of September 11th. It blames an economy swinging from boom to bust and more-generous-than-expected pay deals with the city's uniformed workers. Mr Giuliani's outgoing administration did not help by allocating $2.5 billion of a $2.8 billion accumulated budget surplus to cover additional operating expenditure during this financial year, rather than paying off debt.



In the past, such forecasts have been based on excessively conservative assumptions about revenues, particularly taxes levied on Wall Street firms. On the other hand, this could be the year that shows the wisdom of such prudence. Indeed, the picture may become much worse if some $20 billion of promised aid from the federal government to rebuild lower Manhattan is delayed. Robert Rubin, a former treasury secretary now chairing Citigroup in New York, points out gloomily that most of the aid is currently blocked in the squabble over the federal budget.

Mr Bloomberg has several depressing options. First, he could raise taxes. New York is already arguably the most heavily taxed big city in the country. Nothing is more likely to speed the flight of businesses from the city than higher business taxes. But an old tax on commuters entering the city could perhaps be revived, providing the state assembly could be persuaded to agree (which would be a challenge for any mayor).

Better, he could cut spending, through a mixture of service reductions and productivity enhancements. Steve Malanga of the Manhattan Institute, a think-tank, points out that Mr Giuliani achieved big efficiency gains in his first two years, but then lost interest. A buoyant economy, and thus strong tax revenues, allowed Mr Giuliani to spend freely in his second term and not worry too much about productivity. Mr Giuliani's people are now pointing out some of the easier targets to the new mayor, who is also a Republican. Most of them will involve fights with the unions.

There are also a variety of one-shot schemes, such as asset sales or debt-refinancings. Again, these are things that Mr Giuliani did not need to do. Still, members of his staff are rumoured to have prepared a list

of 20-30 one-offs for Mr Bloomberg. On a similar note, the new mayor may also be able to use September 11th as an excuse to get around the prohibition on borrowing to finance current spending.

This is tricky stuff. But so far Mr Bloomberg has belied his reputation as a political novice. Early visits to Jerusalem, the Dominican Republic and Puerto Rico look politically shrewd. Appointing Marc Shaw as deputy mayor gives him the services of one of Mr Giuliani's most admired former budget directors. But sorting out the budget crisis will involve pain for many people, particularly municipal workers. The battle with the unions will be the first real test of Mayor Mike's political skill.

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The future of farming

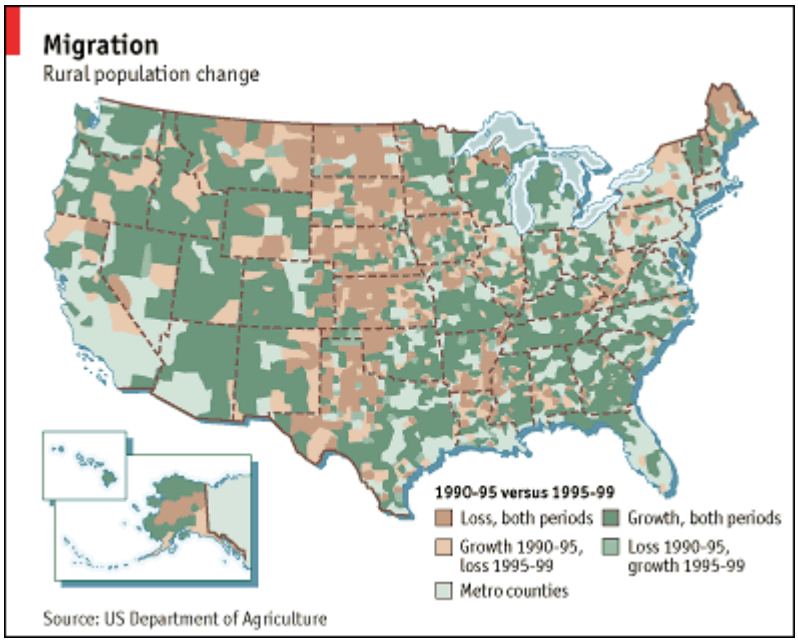
In the Great American Desert

Dec 13th 2001 | MINNEAPOLIS
From The Economist print edition

The Senate debated a $171 billion farm bill this week. But are some rural parts of the country past help? Consider the view from the Great Plains

IN CAYUGA, North Dakota, Mark Saunders recently gave a party for a friend who used to be a farmer. Most of those who came were also ex-farmers, still living nearby only because they have found jobs at a local factory. The lands around Cayuga were once dotted with working farms. These kept the town going; but now Cayuga's main street is derelict, and the church holds services less than once a month. Ed Langeliers, the pastor, fears that, if the small towns go, no one will teach children moral values and the merits of hard work. He also worries that, as small farmers leave the land, larger corporate entities will take over.

His fears are echoed across a region that is reckoned to be dying. In 1930, there were roughly 575,000 farms on the Great Plains, an area that runs roughly from northern Texas to southern Canada, and from eastern Montana eastwards to Illinois (see map). The number dropped steadily over the years until in 1997, according to Myron Gutmann, a professor of history at the University of Michigan, there were only 231,000. But the number of farms bigger than 1,000 acres has increased from 45,000 in 1930 to more than 77,000 in 1997. Between 1930 and 1990, the rural population dropped from more than 4m to around 2.6m. The rural Great Plains have seen more people leaving than coming since the 1940s and, in some counties, even earlier. But the pace of depopulation has accelerated, and there is no agreement on what should be done.



The plains are forbidding and mostly semi-arid lands, covered with short or tall grass and lacking both water and trees. The earliest European explorers did not touch them. Francisco Coronado, exploring in the 1540s, surveyed only a fraction of the plains before he retreated to the Rio Grande. Three centuries later, the area was still marked on maps as the Great American Desert. Yet in the 1860s pioneers decided in earnest to turn this near-desert into productive farmland. The government spurred them on, offering 160 acres to any family willing to farm there.

Heavy rains brought bounty in the 1870s, but by the 1890s dust storms and blizzards billowed over the

plains. Many farmers left, and then returned. By 1930, 5.5m people lived on the Great Plains. Gradually, as farming was mechanised, their numbers fell. In 1930 it took one farmer up to 20 hours to produce 100 bushels (2.7 tonnes) of wheat, using the most advanced technology. By 1975 he could do the same work in a quarter of the time. Today it can be done even faster. With each technological breakthrough, fewer people have to live on the plains.

Lack of water is another factor. This is, after all, a desert. Much of the Great Plains, without ground water, relies heavily on the Ogallala aquifer, a vast underwater reservoir. The Ogallala is dropping quickly; between 1990 and 2000, the net depletion was about 3.62m acre-feet a year. In the 1980s, the federal government in effect ended its policy of underwriting huge dam and irrigation projects for the region's farms and towns.

Profit margins are good, but the community has gone

Many of those who still live there have survived by buying up land from those who have left. Dale Reimers of Jamestown, North Dakota, remembers when farmers lined up to drop off their grain at the local elevator. The Reimers now own the elevator, the most recent addition to what has become a 20,000-acre farm, some 20 times the average size in North Dakota. They are doing well, but Mr Reimer still bemoans the loss of small towns. He would rather farm a quarter of his present land, and have more neighbours round him. Instead, he expects to see fewer and fewer. Profit margins are good, but the community has gone.

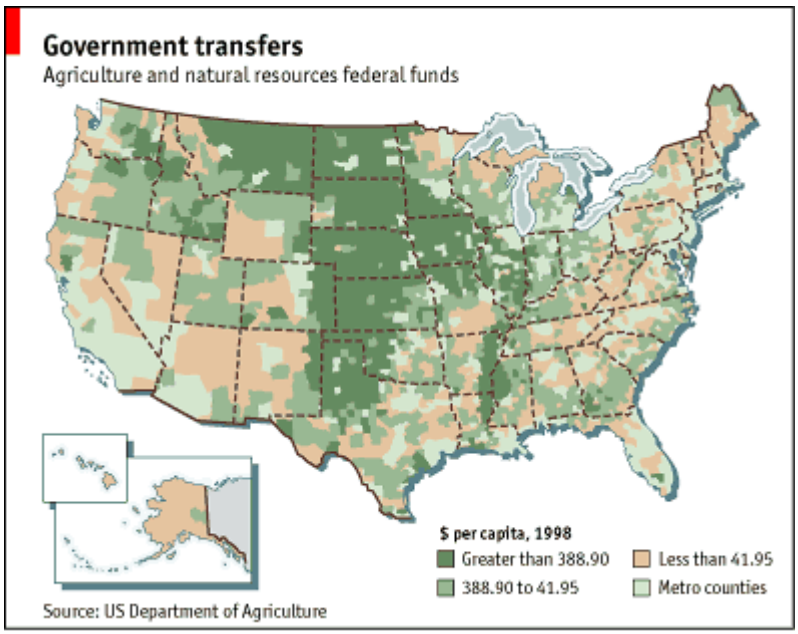
Over the past decade, 47 of North Dakota's 53 counties and 53 of Nebraska's 93 have seen their populations drop. “The demise of the small town”, says Wes Jackson, president of the Land Institute in Salina, Kansas, “and the loss of the cultural capacity is replaced by an industrial mind that is at once simple and simplifying.” Mr Jackson contends that with more farmers on the land, and with more small towns, more care should be taken that farming does not degrade the environment. In other words, Mr Jackson says, America needs a high “eyes-to-acre” ratio.

Mr Jackson's is just one of many arguments offered by those committed to staunching the loss of population on the plains. Although it may make economic sense to abandon a desert, many feel that America is losing a vital part of its character along the way. As farm towns continue to decline, there is a drive to transform America's agricultural policy into a scheme, more like Europe's, that would try to support rural life in general.

Troubled by subsidies

In 1996 the Republican-led Congress passed the Freedom to Farm Act. Among other things, the measure let farmers receive subsidies while planting whatever they wanted, rather than what the government told them to. In return, Congress mandated that the government would, over time, stop supporting America's farms. Commodity prices were good then, and federal payments were low enough to make the plan seem feasible.

But commodity prices plummeted, and five years later federal farm aid soared to $32 billion (bringing the total disbursements over the past 40 years to around $350 billion). Net farm income shows no signs of increasing without federal intervention. Government spending per head in the Great Plains is higher than anywhere else in the country (see map).



Yet if such spending is meant to support rural areas as well as farmers, then the government has failed. In Minnesota's 7th congressional district alone, farmers received some $4 billion in direct government payments between 1985 and 2000. Some small farmers agree that federal payments have helped them stay on the land. But, even as subsidies have increased, farm employment in the 7th district declined by 30% between 1976 and 1998.

According to Ford Runge, a professor of applied economics at the University of Minnesota, “the public does not seem to be getting what they think they are getting.” Roughly 20% of farmers, he estimates, are receiving some 80% of the federal subsidies. This 20% also happen to own the largest farms. They are using the federal subsidies mainly to remain viable, but also to bid land away from other farmers. The cap for federal subsidies is very high; so the larger farms get, the more subsidies they receive. As large farms bid up land prices, capital costs for smaller operations rise, and young people find it harder to buy land. In this way, say Mr Runge and others, the federal government, far from propping up small farming towns, is hastening their decline.

In the 1930s, when farm programmes began, they were seen as a vital part of America's “food security”. The country is now, if anything, over-fed, but farmers still depend on taxpayers for about half their income. This week the Senate inched towards passing a farm bill that would cost $171 billion over the next ten years. This has to be reconciled with an earlier House bill that would cost $168 billion over the next ten years, before George Bush can sign it. The White House is grumpy about both, and foreigners view them as calamitous. The House bill focuses on higher fixed annual payments, the Senate's on higher support prices. But both will pump yet more government cash into the plains, with the lion's share going to big farmers.

Is there another approach? Ann Veneman, the agriculture secretary, has argued that subsidies should be spread more evenly to help smaller farmers, and should include more payments for conservation. Tom Harkin, the Democratic chairman of the Senate agriculture committee, has co-authored a measure called the Conservation Security Act, which could mark a shift towards propping up smaller operations. The bill, now embedded in the Senate legislation, would pay farmers up to $50,000 for managing their lands in ways that protect the environment. Chuck Hassebrook, director of the Centre for Rural Affairs in Walthill, Nebraska, wants the government to set aside $500m in payments to promote ecological or co-operative farming, which might bring more farm jobs.

All these ideas go down badly with owners of larger spreads. To them, preserving small farms means turning the clock back to a vanished age. Bruce Babcock, director of the Centre for Agriculture and Rural Development at Iowa State University, sees no point in trying to expand a workforce that has naturally contracted. In his view, the decline of small farms on the plains is a sign of success. Farm towns need to stop relying on the government and find a new *raison d'être*.

The biggest roller-coaster in the world

Apart from agriculture, the chief resource of plains towns is their people, with their pioneer virtues (so

Americans feel) of persistence and ingenuity. Backers of the countryside see a great deal of entrepreneurial talent lying unused, and some are trying to harness it.

John Allen, director of the Centre for Applied Rural Innovation at the University of Nebraska in Lincoln, travels to small towns to help people find alternative ways to make money. When he met members of the Nebraska Youth Development Network, they told him they wanted to build the world's largest wooden roller-coaster in the Sandhills, which cover two of America's poorest counties. The roller-coaster, they thought, would lure other young people from miles around who would stay and start businesses. Alternatively, they proposed a road race that would draw millionaires from Europe and Asia. Mr Allen turned down the roller-coaster, but the road race will go ahead this year.

Just south of the Sandhills, in McCook, Nebraska, townsfolk are trying to find new ways to keep their town from shrinking. The town's population, nearly 8,000, has declined over the past decade. Many of the smaller towns around are disappearing. Five years ago, people in McCook started the Buffalo Commons Storytelling and Music Festival. That name is notorious on the plains. In 1987 Frank and Deborah Popper, two demographers at Rutgers University in New Jersey, looked at the history of settlement on the plains and concluded that the region was ill-suited to ordinary farming. It should be left, they said, as a “buffalo commons”—a vast restored prairie where buffalo would again roam in great numbers.

At first, plains folk saw the Poppers as east-coast doomsters. Their opposition has softened over time as inexorable forces drive them from the land. Some small farmers have unwittingly followed the Poppers' advice by selling their land to Sioux Indians, who in turn are using the land for buffalo herds.

But looming behind all these efforts is a larger notion: that the settling of the Great Plains is a human experiment which has seen its day. Jack Zaleski, the editorial page director of the *Fargo Forum* newspaper, has watched small towns fade over the past decade while Fargo has grown by some 20%. According to him, the changes in agriculture are so profound that the little towns will never return.

This would have come as no surprise to Major Stephen Long, who travelled through the southern plains in 1819. He reported that the land was “almost wholly unfit for cultivation and of course uninhabitable for a people depending upon agriculture for their subsistence.” American inventiveness—including the six-shooter and barbed wire—and trailer-loads of taxpayer dollars proved him wrong for a while. But it may take a new ingenuity to keep this part of America's heart from fading away.

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Lexington

Treasonous reflections

Dec 13th 2001
From The Economist print edition

Americans—particularly George Bush— shouldn't make excuses for John Walker

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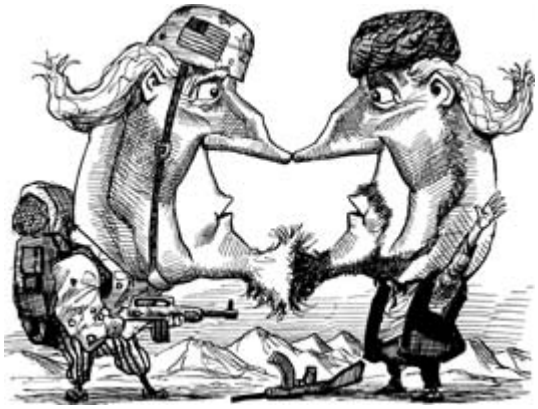

A CHIEF justice, John Marshall, once said that treason is the crime that can most “excite and agitate the passions of men”. He forgot to add that, in America at least, the passion it does most to agitate is that for obfuscation.

John Walker, a Californian airhead turned Taliban fighter, is a traitor by any reasonable definition of the word. He was found fighting alongside the Taliban with an AK-47 in his hand; he took part in a prison riot in which an American CIA agent was beaten to death; he told a journalist that he joined the Taliban as a volunteer and trained in al-Qaeda camps, catching glimpses of Osama bin Laden. This self-styled “jihadist” added that he approved of the mass murders of September 11th. Yet America is undergoing agonies over Mr Walker.

It is perhaps predictable that the citizens of *über*-liberal Marin County should be reluctant to condemn their prodigal son. “I can't see him as being unpatriotic,” says a neighbour. “This is where his journey led him.” But the moral equivocation is not confined to ageing hippies. George Bush, who oversaw the execution of 153 people in Texas, has made room in his heart for America's home-grown Talib. “We're just trying to learn the facts about this poor fellow,” he says. “Obviously he has, uh, been misled.” One poll shows that only about 40% of Americans think that he should be tried for treason.

Why this reluctance to give an obvious traitor his just deserts? In part because Americans are hard-wired to be hesitant about treason. The Founding Fathers regarded promiscuous use of the word as one of the most repugnant features of the old European order, which used it to persecute religious minorities. Treason is one of the few crimes to be defined in the constitution, and the standard of proof is dauntingly high: the testimony of two witnesses to the same “overt act” or a confession in open court. There have been only about 30 prosecutions for treason since the republic's founding. And some of the best-known trials have led to acquittals. Aaron Burr, a former vice-president, was let off despite abundant evidence that he was trying to raise an army against the United States.

Even when they do convict people of treason, Americans have a habit of treating them with kid gloves. They have not executed a single person for the crime this century. Gerald Ford eventually pardoned one of the 20th century's most notorious traitors, Tokyo Rose. Britain hanged John Amery, a Nazi sympathiser, in 1945, despite the fact that his father was both a cabinet member and a close friend of Winston Churchill.

So it is easy to see why Mr Bush is unwilling to enter this legal minefield. One reason why military tribunals are attractive to the administration is because they limit the legal fallout from the war on terrorism. As an American citizen, Mr Walker is bound to be tried before a federal court, rather than a military tribunal; since he is already on the cover of *Newsweek*, he is guaranteed a celebrity trial. Mr Walker's father has hired a lawyer who made his name during the Iran-contra affair. Can the gruesome Alan Dershowitz and Johnny Cochran be far behind?

Mr Walker's defenders will also have a powerful cultural prejudice on their side: the belief that Mr Walker could be any misguided young American. Mr Walker's “journey” may have led him to embrace the idea of killing New York office workers, but the route had plenty of familiar landmarks. He was named after John

Lennon. He embraced Islam after reading a school text, “The Autobiography of Malcolm X”. His mother dabbled in Buddhism. His father, a corporate lawyer, forked out the cash to send him to study Islam in Yemen and Pakistan. Above all, he is a 20-year-old in a country where the age of majority for middle-class whites often appears to be somewhere in the mid-30s.

Far from being embarrassed by Mr Walker, many middle-class Americans seem proud of him. One columnist in the *San Francisco Chronicle* hailed Mr Walker as “a product of Bay Area Culture...Young people here are taught from an early age to accept other cultures and peoples...The Bay Area is also a place that encourages critical thinking about the US role in the world.” That might be a little stronger than Mr Bush would want to put it; but the White House already seems to be hinting at some sort of friendly plea bargain for “the poor fellow”.

All very open-minded. Yet it is hard to avoid the conclusion that, in trying to empathise with Mr Walker, the United States is running away—failing to get to grips with the shallow multiculturalism that produced him, unwilling to risk the new spirit of national unity by replaying old arguments. Yes, the actual charge of treason may be difficult to prove, but there are still plenty of things that Mr Walker could be charged with: espionage, violating the Neutrality Act by fighting in Kashmir, seditious conspiracy, being an accessory to the murder of a CIA officer. He could also be stripped of his American citizenship and tried as a fighter for an enemy power.

Why throw the book at him? Because, if Mr Bush does not, it will make a mockery of both his war against terrorism and America's often vengeful justice system. Mr Walker is no Patty Hearst, goaded into his actions. He freely moved to the heart of Taliban-controlled territory. He is the same age as many of the American troops who are fighting for their country in Afghanistan. Every week people younger than him (often, be it remembered, poor black people) get sent down for long prison terms for trivial offences. Mr Walker's fellow Taliban might at least have had the excuse that they were acting out of ancestral loyalty or ignorance. Mr Walker chose to reject American liberalism in order to serve a regime that oppressed women, stoned homosexuals to death and executed dissidents.

Mr Bush has pledged to hunt down global terrorists wherever they happen to be. He cannot start making exceptions if they happen to have a white face, an expensive lawyer and a cockamamie story about being on a journey of self-discovery.

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Politics in Venezuela

Birth of the counter-revolution

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From The Economist print edition

AP

The opposition has shown it can shut the country down, but President Hugo Chavez is blundering on regardless

Get article background

AN EERIE silence enveloped Venezuela on December 10th, as every city in the country came to a standstill. Offices, factories, schools, shops and other businesses remained closed and shuttered in a 12-hour stoppage called by the private sector, and backed by the main labour confederation, in protest at a bundle of laws decreed by the increasingly authoritarian government of President Hugo Chavez. With the president showing no sign of backing down, Venezuela looks to be heading for an extended period of political turmoil and confrontation.

Until recently, Mr Chavez and his “Bolivarian revolution”, a mishmash of populist statism ostensibly aimed at sweeping away corruption and fighting poverty, enjoyed overwhelming popular support. But the president's hostility to local business has done nothing to revive the economy. Since his election three years ago, he has concentrated power in himself and the armed forces, ruling first by referendum and now by decree. The private sector sees the latest laws, many published with no consultation, as an attack on private property and the market economy; the unions see them as threatening labour rights. With popular expectation turning to frustration, this week's protest turned into a general condemnation of the government.

Mr Chavez did his best to laugh off the stoppage, ridiculing the organisers as a tiny clique from the country's “corrupt and bastard oligarchy”. He switched a flypast for Air Force day, traditionally held on December 10th at a provincial airbase, to Caracas, to underline that “the revolution is armed”. But the roar of jet fighters over the capital was answered by a crescendo of pot-banging in the streets, a now-traditional anti-government protest, clearly audible to the audience at La Carlota, an airbase in the east of the city.

Hours later, at a rally of several thousand diehard loyalists bused in from around the country, Mr Chavez promised to implement “immediately” a new land law, the most controversial of the decrees. Hurling insults against his opponents, he made threats against the media and hinted at using the armed forces to seize emergency powers. Two days later, accompanied by Fidel Castro, a frequent visitor to Mr Chavez's Venezuela, he promulgated a new fisheries law.

Unwilling to compromise

Unacknowledged by the president was the opposition's new-found power to bring the country to a halt. The “deeper phase” of the revolution Mr Chavez promised his loyalists will face resistance. Farmers' and cattlemen's federations have already said that they will not obey the land law. Fedecamaras, the main business federation, is preparing fresh stoppages. Carlos Ortega, the leader of the labour federation, talks of an indefinite general strike.

All this leaves Mr Chavez with a dilemma. Despite his tough talk, the armed forces are unlikely to go along with the imposition of a state of emergency. Any departure from the constitution, itself a *Chavista* creation, is likely to see the United States, and others, seek to isolate Venezuela. But it is hard for Mr Chavez to retreat. Several recent polls have suggested that his approval rating, once over 80%, is now close to 30%. His hard-core followers are mostly at the bottom of the social heap; if he abandons his redistributive promises, they too could desert him. But neither are the opposition's prospects uncomplicated. It lacks political leadership, and represents a still-shaky coalition of sectional interests without a common programme.

For Fedecamaras, the next step is to persuade the National Assembly and the Supreme Court to scrap, amend or at least suspend the new laws. The assembly and the court are supposed to be independent, but both are packed with supporters of Mr Chavez. The day after the stoppage, a debate on the laws in the assembly was prevented when the president's party walked out, leaving parliament inquorate.

In the past, two veteran leftist politicians, Jose Vicente Rangel, the defence minister, and Luis Miquilena, the interior minister, have acted as bridge-builders between Mr Chavez and the opposition. Mr Miquilena controls a block of government supporters in the assembly, and hand-picked the Supreme Court justices. But there are signs that he may resign. That would deprive the government of one of the few remaining voices of moderation.

Mr Chavez first shot to fame in Venezuela in 1992, when as a paratroop commander he led an abortive military coup against an elected government. He has never shown much interest in the patient compromises of democracy. By choosing to polarise the country when his own support has crumbled, he is taking a huge risk. Much of the political debate in today's Venezuela centres not on whether Mr Chavez should go before his term ends in 2007, but when, how—and what comes next.

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The IMF and Argentina

Staying mum

Dec 13th 2001 | WASHINGTON, DC, AND BUENOS AIRES
From The Economist print edition

Nobody in Washington dares tell Domingo Cavallo that he has no clothes

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AP

Time's up for Cavallo's fiscal fantasies

AT FIRST sight, last weekend's meeting between Domingo Cavallo, Argentina's economy minister, and the IMF had an air of farce. Mr Cavallo came to persuade the IMF to restore a loan of $1.3 billion, by discussing fiscal projections that few in Washington believe are realistic. His goal is to avoid default on his country's debt and the demise of its currency-board regime—both of which most international officials regard as inevitable. Yet no one publicly said anything of the sort (nor, it seems, did the IMF say much privately to Mr Cavallo). John Taylor, the top international man at the United States' Treasury, has even recently praised Argentina for dealing "effectively" with its "problem".

To be fair, the talks did make some progress. Argentina's fiscal mess—any remotely realistic projections show gaping financing gaps for 2002 and even bigger ones for 2003 and 2004—is an important part of the country's problems. For the first time, Mr Cavallo was prepared to talk reasonably with the IMF boffins about them. At least the two sides appeared to agree on the scale of the problem.

As a first step, Mr Cavallo promised on his return to Buenos Aires to dismantle the tax breaks for businesses he had boasted would restore growth when he took office in March. But with the economy contracting sharply, these tax rises are unlikely to yield the $4 billion Mr Cavallo expects. Martin Redrado of Fundacion Capital, a Buenos Aires think-tank, reckons eliminating the breaks will provide only $3 billion.

So Mr Cavallo will have to include in next year's budget further fierce spending cuts, by both the federal and the provincial governments. And most Washington officials privately reckon that he will also have to extract much bigger debt write-downs from bondholders than the current restructuring plans envisage.

To solve Argentina's budget problems in the medium term, the economy must start growing. And that, at least as seen in Washington, implies a new exchange-rate regime. So why is no one saying as much to Mr Cavallo? The IMF's official position is that it cannot tell countries to default, and that exchange-rate arrangements are a sovereign decision. "Countries choose their own exchange-rate regime and we determine whether we support it," says Tom Dawson, the IMF spokesman.

The truth is that the IMF has often told smaller, weaker, countries exactly what to do. But it is balking at trying to dictate a change in the exchange-rate regime to a big emerging economy whose citizens are strongly in favour of the current system. In part, this is a real change of philosophy: since the arrival of Horst Köhler, the Fund's German boss, the IMF takes country "ownership" of economic reforms more seriously. But partly, too, it is an attempt to avoid the blame for Argentina's mess—"ass-covering", as it has been put by one Fund-watcher. Mr Cavallo would quickly denounce any pressure from the IMF either to default or to change the exchange-rate regime, and would ensure that any subsequent economic chaos was squarely laid at the Fund's door.

Equally important, the technicians in Washington may agree that Argentina's current system cannot last—but not on what should replace it. Many IMF officials reckon that a floating exchange rate would offer the country its best shot at growth (though floating the peso, everyone admits, would be extremely

risky and potentially chaotic). But a few others in the Fund are said to favour dollarisation (after first devaluing the peso). And certainly the Treasury's Mr Taylor is reported to lean towards the notion that Argentina should simply adopt the greenback.

These reasons may explain the reluctance of the IMF (and of the United States' Treasury) to be more frank with Argentina, but they do not excuse it. By soldiering on in its doomed effort to avoid technical default and maintain the increasingly phoney currency board, Argentina's economic collapse may end up being far more painful than necessary. Though the world's economic elite may be powerless to stop the folly of such action, they should at least be drawing attention to it, in private and if necessary in public.

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Trinidad's election

Dreadlock

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Can the politicians end the paralysis?

AP

MANY voters were no doubt hoping that the second election in a year in Trinidad and Tobago would end the country's political infighting, and give a decisive mandate to a new government. No such luck. The voting on December 10th produced a tie. The ruling United National Congress and the opposition People's National Movement each won 18 seats.

That leaves the country's president, Arthur Robinson, a respected elder statesman, with some tricky decisions. The constitution says he must ask "who is most likely to command the support of the majority" to form a government. He has brought the rival leaders together for talks. Basdeo Panday, the prime minister, is being unusually conciliatory. He wants a power-sharing coalition, saying it should change the constitution to avoid future deadlocks, reform election procedures and investigate corruption. Patrick Manning, the opposition leader, says he should lead any such government. The two hostile parties might just be able to work together. That would be widely welcomed. If they cannot, a third election may be inevitable.

Trinidad and Tobago, with 1.3m people and lots of oil and gas, is one of the Caribbean's richer states. But political uncertainty is doing nothing to help it. And although the country has never suffered the political rioting familiar to Jamaica and Guyana, tempers may eventually fray.

Both main parties claim to be multi-racial. But almost all Indo-Trinidadians, who make up just over 40% of the population, support Mr Panday's United National Congress. And most Afro-Trinidadians back the People's National Movement. Mixed-race voters, a fifth of the electorate, swing the few marginal seats.

Mr Panday's narrow victory in last year's election was tarnished by still-unresolved legal challenges. In September, he lost his parliamentary majority when he sacked three ministers who had accused his government of corruption. Another former minister is on trial for corruption and murder. The appeal court ruled recently that the prime minister had shown bias in the awarding of cellular-telephone licences.

If either partly alone formed a new government, it could limp on for a few months. A budget approved in September remains in force. The prime minister chooses most of the appointed senators who form the upper house. That could be important, since both houses of parliament will meet in joint session to choose a successor to President Robinson, whose five-year term ends in March. In such a finely balanced polity, his job has more than ceremonial significance. For example, the head of state chooses the chief justice, as well as the members of the electoral commission.

On election day, V.S. Naipaul, Trinidad's best-known son, was being awarded the Nobel prize for literature in Stockholm. One of his novels, "The Suffrage of Elvira", concerns a past election. It contains the recurring line: "I promising you, for all it began sweet, it going to end damn sour." Can the politicians devise a happier ending?

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Cuba's army

Paymaster generals

Dec 13th 2001 | SANTIAGO DE CUBA
From The Economist print edition

The armed forces have economic as well as military power

WHEN Cubans gathered in the eastern city of Santiago earlier this month to mark the 45th anniversary of the armed forces' founding, the highlight of the display was a few helicopters and planes buzzing over the crowd. Gone were the missiles, tanks and fancy equipment that were rolled out when the Soviet Union was Cuba's main supporter during the cold war. In military terms, Cuba's army is a shadow of its former self. But it remains at the heart of power in Fidel Castro's Cuba, and has found a new role in managing many bits of the economy.

The armed forces now number only 46,000 active troops (plus 39,000 reservists), down from a peak of 300,000 in the early 1960s, according to the International Institute for Strategic Studies in London. Mr Castro pulled his forces out of Africa's wars a decade ago. The defence budget has been halved since the mid-1980s.

But the army has not been idle. Generals head several economic ministries, running the sugar industry, transport and the ports, civil aviation, fisheries and the merchant marine. And the armed forces' growing business portfolio includes Gaviota, a hotel and tourism company, a car-hire firm, citrus and telecoms companies, and Habanos, the national cigar business.

That gives the armed forces a large degree of financial independence from the rest of the government—which might become important when Mr Castro, who is 75, departs. The army also has political clout. Military officers hold over a quarter of the seats on the Communist Party's Central Committee, and some 400 soldiers are delegates on municipal and provincial councils. At the centre of this accumulation of power sits Raul Castro, the president's younger brother and his officially designated successor.

When the inevitable eventually happens and Fidel is no longer in power, the outlook for the island will be highly uncertain. Many Cubans think that, even if the Communist Party remains in control, Raul lacks his brother's charisma and lust for power, and might be merely a transitional figure. Whatever happens, though, the armed forces are likely to play a central role.

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Canada's budget

Balancing act

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Prudence gets its reward

BRITAIN'S Gordon Brown is not the only finance minister of whom it is said that prudence is his middle name. Paul Martin, his long-serving Canadian counterpart, has presided over the transformation of the federal government's finances during the past eight years, turning a budget deficit of 9.2% of GDP in 1992-93 into a string of surpluses. But now Canada is following the United States into recession. So Canadians were looking to the budget on December 10th to see whether Mr Martin could square an economic stimulus with his familiar fiscal discipline.

He just about pulled it off. Mr Martin announced extra spending of C$7.7 billion ($4.9 billion) over the next five years on various anti-terrorist measures, including stepped-up surveillance at the border with the United States. Mr Martin is also sticking to planned increases in spending on health care and big tax cuts, both announced on the eve of the general election in November 2000.

The tax cuts mean that corporate income tax will fall within two years to 30%—less than that in some American states. They take effect from January 1st. Together with cuts in provincial taxes, in all the fiscal changes will inject an extra 3.3% of GDP this year and 4% next, according to Jim Peterson, Mr Martin's deputy. That is roughly double the strength of George Bush's much-vaunted (and much-delayed) stimulus in the United States. In addition, the Bank of Canada has cut interest rates by 3.5 percentage points this year.

So has Mr Martin thrown prudence to the winds? He claims that the budget will be in balance this year and next (compared with a surplus of C$17.1 billion last year). This assumes that the economy recovers by the end of next year (most private-sector forecasts put growth in 2002 at around 1.2%). “We're not going back to the old ways of profligacy,” says Mr Peterson.

Even so, Mr Martin is skating on thinner ice. He is dipping into the government's contingency fund. Critics say that he has left little margin for error. But if his stimulus turns out to be well-judged, he will have strengthened his claims to take over from Jean Chrétien as prime minister. It has not gone unnoticed that the biggest cut in the budget was in a plan to install broadband Internet in rural areas, championed by Brian Tobin, the industry minister and a rival of Mr Martin's for the top job. It would all sound familiar to Mr Brown.

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Japan

The prime minister who needs things to get worse

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From The Economist print edition

Deflation. Recession. Huge public debts. Insolvent banks. Japan should be in crisis. The problem for Junichiro Koizumi is that it isn't

ANOTHER week, another spate of bad news from Japan's economy. Corporate confidence slid yet again in the Bank of Japan's latest *Tankan* survey. Machinery orders continued to fall sharply in October, down 10.1% from September, a month in which they had already fallen 13.2%. The country's GDP shrank in the third quarter, putting the economy in its third recession in the past eight years. Perversely, the Tokyo stockmarket rallied when the *Tankan* was released on December 12th, perhaps because the bad news was not quite as bad as expected. The real trouble, however, is that the news is not yet bad enough.

Despite all the economic gloom, the seasoned visitor to Japan these days still finds no shortage of the trappings of affluence. But the old arrogance of the 1980s has turned into a rather British mixture of self-deprecation and fatalism. Asked about the latest downgrading by a credit-ratings agency of Japan's public debt, a senior finance-ministry official simply shrugs: “Oh, it'll get far worse than this. We'll soon be rated as low as the Czech Republic.” And why can't he and his colleagues, once thought of as the world's most powerful and gifted bureaucrats, sort this out? “Because our system's no good, and we're no good, and the universities producing new bureaucrats are no good.”

Plenty of people accept that change is needed. Almost every politician, professor or pundit talks about the need for reforms, and most can produce their own “radical” plan. What is far scarcer, however, is the determination actually to implement any reforms that would mete out real pain.

That is not true of Junichiro Koizumi, the prime minister. Since he grabbed the top job unexpectedly in April, in what was in essence a popular coup within the long-ruling Liberal Democratic Party, he has unveiled an ambitious programme of measures, including a lot of privatisation, deregulation and fiscal reform, along with efforts to lift the huge burden of bad debts off the shoulders of commercial banks. He has even begun to implement some of them, notably the privatisation of government agencies. Progress has been slow, and has involved compromises with his political opponents within the LDP, but he has at least moved in the right direction.

The worry is over how much time he has. Mr Koizumi's boosters liken him to Britain's Margaret Thatcher, and point out that her reforms took the best part of a decade to implement. Most Japanese prime ministers, however, last only a year or two at best. Mr Koizumi could prove to be an exception, because he remains remarkably popular: his approval ratings in the *Asahi* newspaper's polls have dipped from their peak of 84% in May, but remained at 74% in November (see chart).

As long as the LDP's elders think that they need Mr Koizumi in order to ensure the party's survival, they will keep him on. But while other leaders have been able to endure falling popularity because of loyal party factions or fund-raising skills, Mr Koizumi's ratings are his only political asset. Even reform-minded colleagues think he could not long survive in office if they were to slip below

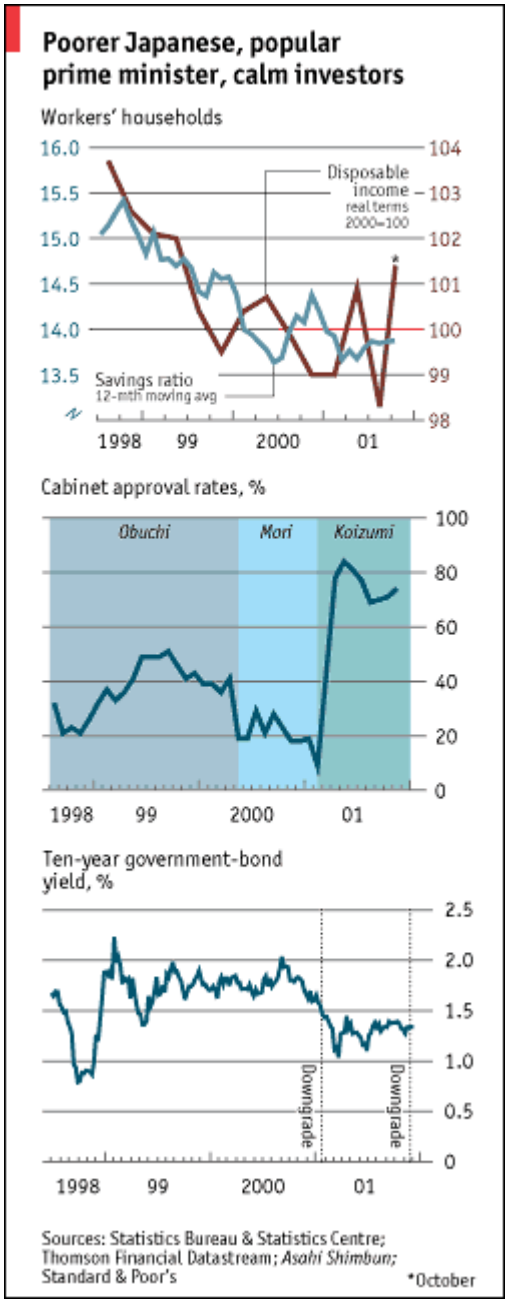
50%.

Fortunately, he is favoured for a good reason: the public supports the idea of reform. To make sure that this idea continues to be associated with him personally, his associates are trying to use direct, often American-style methods to get his message across: interviews with popular “sports tabloids” rather than the mainstream media, and “town hall” meetings.

Yet although the idea of reform is popular, ordinary voters do not feel a sense of crisis. Unemployment has risen, but only to 5.4% of the workforce. Incomes have been declining, but only gently, and there have been higher rewards for the most talented. And one of the big bogeymen for economists is actually a boon for consumers: deflation. With prices falling by around 1% a year, life is becoming more affordable. If there were sharp cuts in wages, either directly or through the job-sharing schemes that some pundits advocate, deflation could become painful. For the moment, though, it has its advantages.

The true victims of deflation are debtors, because the real burden of repayment, which is fixed in nominal terms, rises as prices fall. That hurts the banks' heavily indebted corporate customers, and so the banks themselves. The biggest debt burden of all, however, lies on Mr Koizumi's own desk: the government's debts have reached 130% of GDP. They are rising even as falling prices make repayment costlier; and meanwhile GDP itself is shrinking and so are tax revenues.

In principle, this could be helpful to the prime minister. It should give him a rod with which to beat the back of opponents of change; many LDP colleagues oppose reforms that will hurt the vested interests that form their support-base. The trouble is that this rod too is floppy. Japan's domestic savings are still abundant, and there are still plenty of buyers for government bonds. Despite all the downgrading and despite the growing public debt, investors in government bonds have remained calm, and yields low.



In truth the prevailing mood is one of gradualism, not radicalism. That is dangerous for Mr Koizumi. His reputation depends on his ability to deliver his reforms. Without them, his ratings could slide, making it hard for him to survive any subsequent economic crisis. But without an early crisis, he is unlikely to deliver much.

Mr Koizumi's best hope, strangely, would be if his own government's credit rating were to be lowered to Czech levels or beyond and if then, as a result, bond prices were to collapse. At that point, at last, change would have become unavoidable. Perhaps that finance-ministry official was being optimistic, after all.

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Politics in Japan

Stranger than fiction

Dec 13th 2001 | TOKYO
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Political satire is no match for the truth

BRIBERY scandals. Blackmail. A dashing new prime minister keen for reform. The evil politicians in his party out to stop him. No, this is not the latest political bulletin from Japan. It is “Let's Go! Nagatacho”, the country's first political spoof on television, which, after a three-month run, aired its last episode on December 12th.

The programme is set in Nagatacho, Tokyo's political district. Junichiro Koizumi, the real-world prime minister, is given an *alter ego*, Shunichiro Izumi, played by a rugged actor with a huge following among women. Otherwise, the impressions are not flattering. The fictional foreign minister, Maiko Tazaka, is portrayed as abrasive and power-hungry, a sly take on the sharp-tongued and ambitious Makiko Tanaka, the real one.

The programme folds in, with slight twists, many big political events of the past year. Thus the main characters get caught up in a revolt that threatens to split the ruling party and are involved in a tussle with anti-reform bureaucrats. And real, continuing battles are also included. For example, the prime minister gains the upper hand in his fight against anti-reformers in his party when he secures a list of politicians involved in a price-rigging scandal in the construction industry. In the last episode he shields them in return for their support for some watered-down reforms.

Being Japan, this could actually happen. But what gives the programme's “predictions” an extra sting is that its script is based on a popular cartoon strip that runs in *Shukan Post*, a magazine that gets lots of political scoops. Kenny Nabeshima, the cartoon's author, is a journalist on the magazine who has been covering politics for 30 years. Real political folk reading the cartoon on the sly admit that, though exaggerated, it captures life in Nagatacho rather well.

Alas, the show's ratings have been poor. Televised parliamentary sessions now attract three times as many viewers as they used to, thanks to the popular Mr Koizumi. The equally popular but gaffe-prone Mrs Tanaka, who is trying to reform the scandal-ridden foreign ministry, has also provided plenty of fodder for reporters. They had a fine time over the affair of a ring of hers which seems mysteriously to have disappeared at the ministry. The resulting storm almost turned into an international incident when a visiting foreign dignitary was kept waiting while a senior bureaucrat was dispatched to buy her a new ring. With drama like this, who needs fiction?

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Australia's Labor Party

The natural party of opposition?

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Australia's Labor opposition is struggling to remake itself

Get article background

A FEW years ago, when it was winning election after election, the Australian Labor Party's most fervent supporters started talking of it becoming the natural party of government. Between 1983 and 1993, under first Bob Hawke and then Paul Keating, Labor won an unprecedented five consecutive elections until John Howard, leading the Liberals, unseated it in 1996. Since Mr Howard won his own third consecutive election victory on November 10th, Labor has been in a state of shock, and many wonder whether Australia's oldest political party should now be considered the natural party of opposition.

Not if Labor can help it. A mere week after its rout, it replaced Kim Beazley, who had stood down after his second defeat at Mr Howard's hand, with Simon Crean as its leader. Mr Crean is an outwardly tougher and more decisive figure than Mr Beazley, whose strategy of keeping his head down and hoping to coast to power on a wave of public disgruntlement with the Howard government, and its sales tax in particular, is being blamed for much of the Labor debacle.

But Mr Crean brings to the job his own electoral baggage, and this goes to the heart of the debate that Labor's latest defeat has prompted about the party's future relevance. Although he is a lawyer and economist, Mr Crean's main role before he entered Parliament 11 years ago was as president of the Australian Council of Trade Unions. The Labor Party was born from the union movement in the 1890s. True, the governments of Mr Hawke and Mr Keating managed to keep the unions on side while embarking on market-driven reforms to the economy, including a reduction in the number of unions. But its union links are now the focus of questions about where Labor belongs in modern Australia. The party remains driven by factions, which derive much of their power from various parts of the union movement. Patronage by factions has tended to deliver parliamentary seats to former union bosses and “mates” instead of drawing candidates from a wider field.

Now that more Australians, 52%, own shares than the 25% who belong to unions, the dominant role of the union movement in Labor's affairs seems an anachronism. Carmen Lawrence, who once led Labor in Western Australia, is among the senior party figures who have come out to demand an end to the “60-40 rule”, whereby unions control 60% of votes at the conferences where party policy is decided. Mr Crean has made a good start by sweeping out Labor's former team of shadow ministers, many of them creatures of the factions, and installing his own team based on talent rather than past union affiliation. For the first time the job of deputy leader has gone to a woman, Jenny Macklin.

Mr Crean calls these appointments the first step in the “renewal and modernisation” of the Labor Party. But more difficult steps lie ahead. During his first five years in government, Mr Howard brought in laws that progressively weakened union powers, and he has more planned for early next year. One, for instance, would remove the restrictions that make it hard for small businesses to dismiss workers; another would insist on secret ballots before strikes. A debate on how Labor should respond opened on December 13th. Its outcome may be crucial to Mr Crean's task of reinventing the party—and avoiding yet another term in opposition.

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India

Unparliamentary conduct

Dec 13th 2001 | DELHI
From The Economist print edition

Were Pakistanis involved?

Reuters

An attack on the heart of government

SEPTEMBER 11th was far more devastating, but the attack on India's Parliament on December 13th will reverberate. How widely depends on the identities, still unknown on Thursday afternoon, of the half-dozen terrorists who began shooting while hundreds of politicians, including some of the country's leaders, were inside the building. None was hurt, but five policemen and all the terrorists were reportedly killed. The terrorists also planted a bomb, potentially much bloodier.

The assault put people in mind of an attack in October on the legislature of the Indian-controlled part of Kashmir, a Muslim-majority state fought over by India and Pakistan. That attack, by car bomb as well as gunmen, looked like the work of Pakistan-based insurgents: one such group, Jaish-e-Muhammad, took responsibility for it, but later retracted the claim. If those who have now struck at the heart of India's polity turn out to have Pakistani connections, the consequences could be grave. Both countries have nuclear weapons and have fought three full-scale wars. India's patience with “cross-border terrorism” has worn noticeably thinner since the September 11th attacks. The latest outrage could strengthen hawks, who argue that India should retaliate George Bush-style against groups with bases in the part of Kashmir controlled by Pakistan and in Pakistan proper. To avert that, Pakistan's president, Pervez Musharraf, may have to act against them himself.

India's home-affairs minister, L.K. Advani (a powerful hawk), described the attackers as *fedayeen* but pointed no immediate finger at Pakistan. India is home to plenty of other insurgents (nationalists in the north-east, for example, and Maoists in the middle) who have the motive and, maybe, the means.

The operation may end up strengthening the government it was meant to injure. Before it, the coalition led by the Bharatiya Janata Party was in trouble. The opposition was up in arms, ironically, over a proposed anti-terrorism law it regarded as draconian. The embattled government has been further embarrassed by reports of corruption in defence procurement, including the purchase of what look like wildly overpriced coffins for soldiers. The opposition was calling for the head of the defence minister, who had just been reappointed after resigning earlier this year over another arms-purchase scandal. The uproar paralysed Parliament for three days this week.

Now that Parliament has become the target of terrorism, the opposition will find it harder to argue against the government's plans for thwarting such acts. Over-priced coffins may seem less of a threat to national security. As Mr Bush has discovered, catastrophe can work wonders for a government's reputation.

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About sponsorship

The Philippines

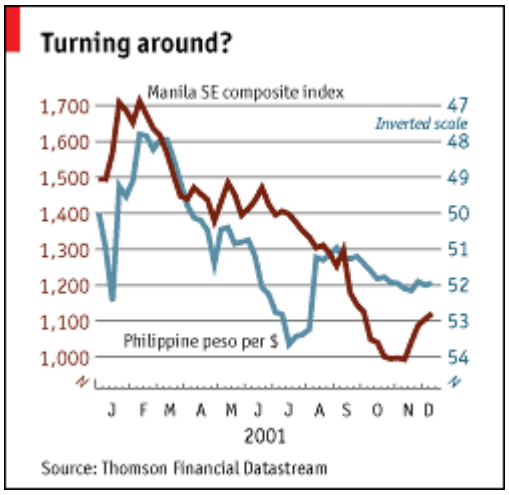
The good earth

Dec 13th 2001 | MANILA
From The Economist print edition

Farming keeps the economy going

TRUE to form, the Philippine economy is still the odd man out in East Asia. But “odd” in the present circumstances means it is one of the best performers in the region, not one of the worst. Resilient domestic demand is keeping GDP growth chugging along at 2.9%, faster than most of its neighbours. On December 10th, President Gloria Arroyo presided over what she called a “national socio-economic summit”, bringing together prominent figures in government, business and the trade unions to set out ways to help the Philippines do even better.

Some observers have tended to put the Philippines near the bottom of the heap of wheezing Asian tigers. Its main markets are the United States and Japan, and its principal export is electronics. It was not surprising, then, that its exports should have fallen in the past year as the technology bubble burst and the world's biggest economies headed for recession. But the Philippines was never one of the real tiger economies, and exports never played the vital role they did in the growth of neighbouring economies. It remained largely an agricultural economy, and what was considered a weakness in the 1990s is now proving to be its strength.



Respectable growth in the farm and service sectors helped to overcome the negative effects of political instability at the beginning of this year, when a popular uprising deposed Joseph Estrada as president and replaced him with Mrs Arroyo. So did the fact that Mrs Arroyo had been trained as an economist, whereas Mr Estrada's main qualification for the presidency was his fame as a film actor. Mrs Arroyo went to work at once on a strategy of further encouraging domestic demand, concentrating on agriculture, housing and the creation of 1.3m jobs in two years. This makes sense in a country where two-fifths of the population depend on agriculture for their livelihoods, and where one-third live below the official poverty line.

Even so, the future is not exactly rosy. In the prevailing international climate, the president has little choice but to try to boost the domestic economy. And there is a limit to what she can do. Her government inherited a growing fiscal deficit from Mr Estrada, which will take years to put right. The government's deficit target for this year is 145 billion pesos ($2.8 billion).

In the private sector, the banks remain hobbled by bad loans. And any effort to overcome the reticence of foreign investors is hampered by perennial problems: creaking infrastructure, a sclerotic bureaucracy, ubiquitous corruption, widespread crime, persistent communist and Muslim-separatist insurgency, and the spectre of further political instability. Mrs Arroyo's summit was intended as a show of national unity and determination. It approved a document identifying some short-term measures to help deal with some of these problems. At the conference, Mrs Arroyo acknowledged that her critics had dismissed the summit as “hot air and propaganda”. But she tried to reassure the sceptics that her administration would not make the mistake of previous Philippine governments in assuming that saying something is the same as doing it.

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Rural China

And there's another country

Dec 13th 2001 | LIANGTOUYUAN, SHAANXI PROVINCE
From The Economist print edition

China's rural governments are bust

The house of learning

THE rural administration of Liangtouyuan, a cluster of villages in the rugged hills of Shaanxi province in north-western China, is crippled with debt. It cannot pay the teachers who work in its dilapidated schools. Even government employees must pay their own medical bills. The nearest market for farm produce is 15km (nine miles) away—involving a journey too arduous for most villagers to attempt. Instead, they grow just enough to feed themselves. Building a proper road is beyond the local government's dreams.

Liangtouyuan is unusually poor, but the financial problems of its government are familiar to most parts of rural China, where life is very different from that in the booming coastal regions. Rural-government debts have ballooned in recent years as a result of reckless spending and investment, growing health and education burdens, corruption and the expansion of bureaucracy. China's accession to the World Trade Organisation on December 11th could aggravate the malaise in much of the countryside as the incomes of millions of peasants—upon whose fees most rural governments depend—are threatened by cheaper agricultural imports.

After three months without pay, the 18 middle-school teachers of Liangtouyuan at last received their overdue wages this summer thanks to the intervention of the Luonan county government, which is responsible for 30 rural administrations, or townships. Last year was even worse: the teachers waited six months. The county has its own difficulties. Luonan's biggest industries—state-owned gold and coal mines—are all but bankrupt. The prices of medicinal orchid tubers and the county's other main agricultural products have slumped.

The president of Liangtouyuan township's middle school spent two months in hospital last year after suffering a stroke. This cost him the equivalent of more than a year's salary. He was lucky to have friends willing to help. Well over a third of those who live in China's countryside cannot afford to see doctors, and rural governments are too poor to help out. Liangtouyuan middle school, financed by the township government, has broken windows and no heating. Only the better-off children can afford charcoal burners to warm their hands and feet during lessons.

The central government's proposed solution involves the biggest reform in the Chinese countryside since the disbanding of the communes 20 years ago. Gone will be the fees paid by farmers to support township governments. Instead, farmers will pay tax to provincial governments which in turn will finance lower-tier rural administrations. This in theory should prevent the townships from demanding excessive fees from peasants in order to meet their debts. It should also force them to trim their staff. Since the mid-1980s, the average number of civil servants per township government has increased tenfold, to about 300.

The “tax-for-fee” reform, as China calls it, has been tried out in the eastern province of Anhui and parts of other provinces in the past two years. The results have been mixed. Many peasants find they are now paying out less to officialdom, which is good news for Chinese leaders worried about a potential explosion of rural discontent caused by growing fees and widespread corruption. But many township governments have simply ended up even poorer—and therefore even less well equipped to provide essential services. The central government has offered $2.4 billion to help make up shortfalls, which is nowhere near enough.

China announced this week that a third of its provinces would try out the tax-for-fee system next year, but that it was too soon to impose it on the whole country. Meanwhile, Luonan county has grown weary of bailing out Liangtouyuan township. The township government is being dismantled in the coming months in order to trim costs. Residents worry about having a new government farther from where they live look after their interests. “After this, officials may pay less attention to Liangtouyuan. If we want a road they may say, why bother?” says one.

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The Palestinians

Arafat's choice

Dec 13th 2001 | RAMALLAH
From The Economist print edition

He is hammered by Israel, and caught between the contrary advice offered by his lieutenants, Muhammad Dahlan (left) and Marwan Barghouti

Get article background

"YASSER ARAFAT is no longer relevant to the state of Israel," decreed the statement from Ariel Sharon's office "and there will be no more contact with him." This announcement followed an ambush on December 12th by Palestinian gunmen on an Israeli bus near a Jewish settlement in the West Bank, killing ten people. The al-Aqsa Brigades, an armed faction linked to Mr Arafat's own Fatah group, claimed responsibility, saying the attack was to avenge the killing of four Fatah fighters in Gaza the day before.

Hamas also claimed the ambush, as well as the two suicide-bombers who blew themselves up near a Jewish settlement in Gaza the same day, killing nobody else. Given the bloodiness of the conflict, there is no shortage of claimed Palestinian motives. A day earlier, the crowds at the funeral of two children, who had been killed by mistake in Israel's attempted assassination of an Islamist in Hebron, had called for "revenge in Tel Aviv".

Israel's first military response to the ambush was to shell Palestinian police stations throughout the West Bank and Gaza, as, indeed, it has been routinely doing for some time. These policemen are the basic arm of Mr Arafat's rule, the men who had been told again and again by Israel to bring the gunmen to heel. But now there has been a political change in Israel, or at least a symbolic one. Israel's political response to the ambush has been to threaten that it itself would now do the job alone. Mr Arafat is "directly responsible for the terror attacks", said the cabinet on December 13th.

Yet Mr Arafat remains increasingly under pressure from outside to act to end the violence. The European Union has now joined the United States in saying that it is up to him. The EU's foreign ministers, meeting in Brussels on December 10th, told him brusquely that he must dismantle the "terrorist networks" of Hamas and Islamic Jihad, arrest and prosecute all "suspects" and appeal, in Arabic, for an end to the armed *intifada*. They also called on Israel to end the assassinations, lift the sieges on Palestinian towns and freeze settlement building in the occupied territories. But everybody is aware that the onus is now on Mr Arafat to act first.

Assailed on all sides, Mr Arafat has been telling his people—at Fatah demonstrations, at a "town hall" meeting in Ramallah attended by members of the worried middle class—that there is only one Palestinian national authority, and he is it. After the ambush he moved to prove it, ordering the closure of all institutions belonging to Hamas and Islamic Jihad. It was an unpopular step, and Mr Arafat is acutely

alive to the criticism he faces within, as well as outside, his own house, with many Palestinians already positioning themselves for the succession.

His Palestinian critics divide themselves into two broad streams. The argument of one stream, expressed with eloquence by the two PA security chiefs, Muhammad Dahlan and Jibril Rajoub, is that the survival of the authority (and their own positions within it) is in the supreme interest of the Palestinian people, even at the cost of ending the *intifada* and resuming security co-operation with Israel.

They would prefer any ceasefire to be negotiated with the various Palestinian political and military factions and, in Mr Dahlan's case, to be accompanied by reform in the Palestinian government. But they are ready to impose order by force—if only Mr Sharon and his army would grant them latitude to do so by halting the assassinations and the bombardment of the authority and its security services.

The other stream is led by the young, armed fighters newly fortified by the uprising. Islamists from Hamas and Islamic Jihad are included, but the grouping is led by Tanzim, Fatah's own field organisation, and militias within it, such as the al-Aqsa Brigades. Many of Tanzim's members are or were officers in the PA's security forces—a confusion that helps to explain why Israel is striking at policemen.

The promise of these fighters, delivered by such spokesmen as Marwan Barghouti, the West Bank's Fatah leader, is that the *intifada* will end only with independence. They possess neither the loyalty to the PA, nor the positions within it, to be prepared to sacrifice all for its survival. For them, it is the *intifada*, not a ceasefire, or the distant hope of peace, that is bound up with their own future claims to leadership.

Mr Arafat's enduring skill had been to sail between streams. Throughout the seven years of the Oslo peace process, he would switch between being president of the Palestinian Authority, when he needed to get tough with his own dissidents, and being chief of the Palestine Liberation Organisation, when he wanted the Tanzim to raise the heat on Israel.

But in the chaos of the *intifada*, the heat has become a fire that is searing his authority. The world is telling him he must douse the flames, admitting that the *intifada* has been a tragic failure. His own Fatah people are warning him that, if he does this, he will risk losing whatever nationalist credibility he and they still command among the Palestinian people as a whole.

For Mr Arafat, this is the toughest of decisions. Whatever he chooses, he will lose out. But the longer he wriggles, the more likely it is that Israel will choose for him.

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Kenya's dynastic politics

Moi and his band of young turks

Dec 13th 2001 | NAIROBI
From The Economist print edition

Daniel arap Moi's retirement plans

RIOTS in Nairobi this month, in which at least 17 people were killed, illustrate the way in which Daniel arap Moi has held on to power for 23 years by manipulating ethnic and political loyalties. The trouble began last month when the president suggested to the Luo residents of a big slum district that perhaps they need not pay their Nubian landlords since the land belonged to the government. On December 3rd, Raila Odinga, a Luo leader who was recently brought into government, repeated Mr Moi's words. Within hours, rival Luo and Nubian gangs were hacking at their neighbours with machetes, and looting and burning their shanties. Hundreds of destitute people are still camped around Nairobi, afraid to return to the wreckage.

Whether Mr Moi genuinely meant to offer the Luo his patronage in reward for Mr Odinga's new loyalty, or to stir up trouble as a way of keeping Mr Odinga in check, is still unclear. The president is a master at wrongfooting his triballydivided followers and opponents alike.

But now Mr Moi faces retirement, the toughest test of all. If he is to safeguard his name and fortune after he has to step down at next year's election, he must ensure that his unpopular Kenya African National Union (KANU) party is returned to power. To do so, he almost certainly needs the votes of Mr Odinga's National Development Party (NDP). But he is not, as yet, inclined to say who among the rivals he will nominate as his successor.

Mr Moi says that a merger between KANU and the NDP is imminent. That would give the ruling party around 30% of the vote—ten points short of the figure that has delivered victory in the past. But Mr Odinga says there will be no merger. He apparently first wants a guarantee of the KANU presidential nomination, or some other plum. Unless Mr Moi can find a more pliable partner, he may have to grant Mr Odinga his wish. This could end the ambitions of his long-serving deputy, George Saitoti, since Mr Odinga and Mr Saitoti would not find it easy to work together.

Mr Saitoti's mother's tribe, the populous Kikuyu, mostly oppose Mr Moi, whom they accuse of neglecting central Kenya in favour of his native Rift Valley. So it is not clear what block of votes Mr Saitoti's presidential candidacy would carry. Yet, by keeping his intentions under wraps, Mr Moi ensures that Mr Saitoti and his supporters, and quite a few other members of parliament too, hold back from organising a rival alliance.

Meanwhile, Mr Odinga has attached himself to Mr Saitoti's main rival, Musalia Mudavadi, who is minister of transport and a member of the Luhya tribe. Both men are the sons of former ministers. But, significantly in a country where politics are dynastic as well as tribal, Oginga Odinga crossed over to the opposition from KANU, while Moses Mudavadi remained loyal to Mr Moi.

Around their two sons has gathered a multi-tribal team of young hopefuls. One of them is Uhuru Kenyatta, a newly appointed minister and a Kikuyu, whose father, Jomo Kenyatta, was founder and first president of independent Kenya. Others are William Ruto, an influential assistant minister, and member of an ethnic group that is close cousin to Mr Moi's own Kalenjin group; and the security chief, Julius Sunkuli, who is a Masai.

Apart from the veteran Mr Odinga, all these men are in their 30s or early 40s, which fits nicely with some recent disparaging remarks by Mr Moi about grey-haired politicians. Kenya's press calls them “the young turks”. When Mr Moi flew to see George Bush in Washington recently, he took them with him. Together, they have a chance of representing most of the Luhya, Luo, Kikuyu, Kalenjin and Masai tribes—a formidable ethnic block.

But, despite their dynamic name, the young turks represent no fresh ideas, only old expedience. They are the creation of a regime that has survived on tribal patronage and loyalty, letting corruption thrive. They could be easily divided if Mr Moi or his strategist, Nicholas Biwott, the trade minister, turned against one or other of them. And, if they stick together, they will have to agree about a way to share power.

For the time being, all this creative confusion suits Mr Moi's purposes pretty well. Similar situations in the approach to previous elections—including tribal clashes, a surge of last-minute party registrations, and rejigged electoral lists—have helped return KANU to power by narrow margins. But those pre-election tribal clashes also caused hundreds of deaths.

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AIDS in Africa

You'd better believe it

Dec 13th 2001 | OUAGADOUGOU
From The Economist print edition

Burkina Faso's fight against AIDS

Get article background

ON TELEVISION a few years ago, Mamadou Sawadogo, a nurse, announced that he was HIV-positive. No one believed him. Until recently, people in Burkina Faso usually assumed that anyone infected must be bedridden. Many even doubted that the virus existed. Such ignorance is rarer now, in Burkina and other poor countries, thanks partly to the efforts of the thousands of scientists, activists and politicians who descended this week on the dusty town of Ouagadougou for the 12th international conference on AIDS and sexually-transmitted diseases in Africa.

Barely a decade ago, such conferences were held in Europe and attended largely by white scientists. These days, most of the participants are African. Senior politicians, who until recently would not have stooped to discussing sex, are now publicly alarmed. In countries such as Uganda and Senegal, where every government department pitches in and non-governmental organisations are given free rein to fight the disease, HIV prevalence has been held down or even rolled back.

But the overall picture is still awful. An estimated 2.3m Africans died of AIDS this year. Another 28m are under sentence of death. According to UNAIDS, $7 billion-10 billion would be needed each year to cope with the disease in Africa, but less than $500m is being spent.

West Africa has suffered less than the eastern or southern parts of the continent, but Burkina Faso is a woeful exception. Perhaps one Burkinabe in ten is infected. The government set up a national committee to curb the epidemic some 15 years ago. The president, Blaise Compaoré, speaks often about AIDS, and donors have promised 70 billion CFA francs ($95m) to help implement a grand five-year plan. A multitude of local associations has sprouted to support the sick, test the courageous and educate the ignorant.

Unfortunately, many of these noble efforts are poorly co-ordinated. Bureaucrats in the capital seem not to communicate with the locals. Donor projects, especially bilateral ones, too often overlap with each other. In rural areas, where few people can read, information spreads slowly. Townspeople may know more but often do not act on it.

Many Burkinabe would rather not know whether they carry the virus. What is the point, they ask, when they cannot afford treatment? The government negotiated price cuts with some drug companies earlier this year, but a month's supply of anti-retroviral drugs still costs 60,000-80,000 francs or about $95. In a country where the annual GDP per person is a paltry $235, few can afford this for long. Mariam Konkobo Saba, a civil servant who has lost her husband and three children to AIDS, has spent most of her life's savings on treatment. She knows that when her money runs out, the virus will kill her.

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Farming and hunger in Ethiopia

Will they ever have enough food?

Dec 13th 2001 | GODE
From The Economist print edition

Some day, but not until Ethiopia has better roads and secure land tenure

Reuters

A hot, hard walk to the river

WITH one hand holding her headscarf in place, a young woman threw stones vigorously into the river. She kept bombarding the brown waters until she was satisfied that the crocodile lurking below had been frightened off. Nimbly and nervously, she filled two plastic jerrycans and turned to carry them home, far away across the sand, under the searing sun.

In the Ethiopian desert, women risk their lives for water. When the rains failed last year, the streets of Gode, a small town in the Somali region of southern Ethiopia, were suddenly thronged with emaciated children. A swift appeal for help brought food aid to the area and probably saved hundreds of thousands of lives. But perhaps 5,000 people died. And, says Askar Ahmed, the acting governor of Gode province, the crisis is not over. Most people's cattle and goats died last year, so they have no way of coping if the rains fail again.

Ethiopia is famous for its famines. In the 1970s, Emperor Haile Selassie fed his dogs morsels from silver plates as his subjects starved. A drought in 1984-85 was turned to famine when the Marxist despot, Mengistu Haile Mariam, first denied the problem and then hindered the delivery of aid. Today, Ethiopia is still one of the hungriest nations on earth. But it is slowly growing less so.

Mr Mengistu was ousted in 1991. A new ruling party, led by the current prime minister, Meles Zenawi, began by promising “revolutionary democracy” but quickly adopted quite market-friendly policies. In non-drought years, the country now grows more food: production of cereals and pulses, for example, rose from 7.5m tonnes in 1994-95 to 12.6m in 2000-01. But progress was hobbled by a senseless border war with Eritrea in 1999-2000. And despite a gradual improvement in living standards, parts of Ethiopia remain chronically vulnerable to famine.

Gode is in the heart of one such area. The kilt-wearing ethnic Somalis who live in the surrounding desert are nomadic pastoralists by tradition. They live in temporary shacks of sticks and hide, which they dismantle and carry with them when they move. They are proud of their way of life, but are now being forced to change it because they no longer have enough pasture for their beasts.

The government tries to spot famines before they kill. Food aid usually arrives in time, more or less. Aid agencies maintain offices in Gode, and are poised to respond to any sudden crisis. But the nomads do not

want to remain permanently dependent on handouts, so many have settled down and started to grow maize.

When the rains are good, they do well. But when drought strikes, their seeds will not grow in the hot sandy soil. Irrigation, and more fertiliser, might solve the problem. Unfortunately, fertiliser is twice as expensive in Gode as in the capital, Addis Ababa. So is the fuel needed to pump water out of the river. The reason is that Gode is in the middle of nowhere and has no tarred roads. Its remoteness also depresses the price its people can get for their surplus crops in good years: they cannot afford to truck their produce to city markets.

The government encourages the provision of microloans for peasants to buy fertiliser. It is even considering encouraging farmers in arid regions to move to wetter ones. But this could be tricky: some clans and ethnic groups are homicidally hostile to intruders. Moreover, memories linger of the way millions of peasants were herded at gunpoint into rural labour camps by the Mengistu regime. The very idea of resettlement has unpleasant associations in the minds of many Ethiopians.

About 85% of Ethiopians are farmers. But if the country is to wean itself off food aid, its people must get better at producing things other than food. If Gode had better roads, residents would be able to earn more cash, which would help them to cope in dry years. If there were more than one telephone line—controlled by obstructive bureaucrats—among Gode's 60,000 people, small businesses might spring up.

More secure land tenure would also help people to feed themselves. Farmers are not at present allowed to sell their land or mortgage it. So they find it hard to raise the capital to make their fields more fruitful. A plan is afoot to allow leasehold titles that could be used as collateral for loans: freehold tenure remains unconstitutional.

In the meantime, millions of Ethiopians wait fearfully each year for the rains, ready to run out and plant their seeds as soon as the ground is damp. As your correspondent left Gode, a light shower fell. People smiled hopefully in their doorways. Perhaps this time they will have enough to eat. But next year?

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Poland's new government

Pot-holes on the road to Brussels

Dec 13th 2001 | WARSAW
From The Economist print edition

EPA

The government has already hit trouble, especially over joining the EU

Get article background

ITS much-vaunted new middle class no longer seems to be growing apace. Its health service is risible, its roads even worse. It lacks the money to overhaul its armed forces or spruce up its civil service. After years of dazzling economic growth, Poland appears to have hit a wall.

The government of the ex-communist Democratic Left, led by Leszek Miller (pictured above), knew as much when it took office after winning the general election in September. The state finances were a mess. The negotiations to join the EU had stalled. After poring over the books, the government now says things are even worse than expected. Foreign investment is falling, unemployment rising. The hole in the budget may be a gaping $5 billion. Some Eurocrats, and other applicant countries, have begun to speak openly of Poland as second-rate, hapless, a brake on the effort to expand the EU. France is muttering about delaying enlargement until the Poles are ready—a long time hence.

It is far too early to damn Mr Miller's government, but its Herculean task has left it looking stretched, at best. Compromises made in Brussels on the sale of land to foreigners and the right of Poles to work in the EU have been clumsily handled, leading to a furore at home. The quality of some of Mr Miller's team is in question. Necessary steps to cut government spending and raise taxes may be fudged. Nor is there any sign yet of a much-needed slashing of red tape and tax breaks for small businesses.

Most visibly, the appointment of Andrzej Lepper, a radical farmer's leader, as a deputy speaker of parliament, has backfired. In the election, his populist Samoobrona (Self-Defence) party came from nowhere to win 10% of the vote and 53 seats. Mr Miller hoped that the responsibility of being deputy speaker might “civilise” Mr Lepper. No such luck.

Mr Lepper has cast himself in the role of protector of the poor. “These stinking bones and dung will arrive outside parliament to claim their rights,” he soon ranted to fellow members. He abused the foreign minister, Wlodzimierz Cimoszewicz, as a “scumbag” of “criminal” lineage. Mr Lepper claimed there was evidence of several politicians taking bribes, and named them. For a while, that resonated with ordinary Poles, who see corruption as endemic and have no confidence in the political class. But Mr Lepper's “evidence” was half-baked. On November 29th he was stripped of his deputy speaker's post.

On he raves, though. The Taliban had landed a helicopter in north-eastern Poland, he announced this week, to extract anthrax from Polish cows and smuggle the virus to America in precious stones, with

ministerial connivance, of course.

Yet Mr Lepper cannot just be dismissed as a nutter. He speaks for many farmers, and farming is the biggest unsettled question on Poland's pot-holed road to EU membership. Whatever happens to Mr Lepper personally—he faces multiple lawsuits—the Eurosceptics' hostility to joining the EU is sure to harden. It is not clear, however, that their number will grow. It may not. The rise of the populist right owes more to the implosion of the beaten Solidarity government than to any lurch to xenophobia. Polls show support for joining the EU fairly stable, at around 55%. And Mr Miller's popularity, for all his difficult first weeks, has risen since the election.

Even so, the government will have to do a much better job of communicating the benefits of EU membership to ordinary Poles. That will not be easy. The crucial questions of EU subsidies for Polish farmers and of other aid are still to be negotiated. The government privately admits that farmers cannot expect much in the way of direct payments from Brussels. But it knows that any deal that smacks of discriminating against the Poles could be rejected when the voters get their say on EU entry in a referendum planned for 2003.

Mr Miller has had a boost recently, however. Poland's Roman Catholic hierarchy, which has long dithered about the EU, at last came down firmly in favour of membership. The churchmen still reckon the Union is anti-religious, but now say it is the duty of Polish believers to convert the “pagans” from the inside.

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Germany education

Dummkopf!

Dec 13th 2001 | BERLIN
From The Economist print edition

Germans have long been proud of their schooling. Too long, it seems

THE shame of it! In a new study of school pupils' performance by the OECD, Germany, the world's third-biggest economic power, the “land of poets and thinkers”, was ranked a miserable 21st out of 31 countries for the reading abilities of its 15-year-olds, 20th in mathematics and 20th in science. A country long proud—and seemingly with reason—of its record in education has been shown up as a *Dummkopf*. Its government and citizens alike are in a tizzy of alarm and self-doubt.

“Shocking”, “scandalous” and “catastrophic”, politicians, parents and educators have wailed in unison. And beneath the average figures lie others even more shocking for Germany's deeply democratic burghers: evidence of a wide gap—one of the widest found by the OECD's researchers—between Germany's highest-performing students and its lowest. Nearly a quarter of its 15-year-olds could not read and understand a simple text. Not that Germany can take much comfort from the achievement of its pupils at the other end of the scale. Only 28% of its 15-year-olds reached the study's top two levels of reading ability, compared with half in Finland (which was ranked first overall) and over a third in a dozen other countries.

How can this be? Whatever else, Germany is famous for its thoroughness. Its technical education was one of the wonders of the 19th century, and long after. What has gone wrong? Almost as alarming as the figures, no one can tell.

Blaming the large number of students of foreign descent, who account for one in ten pupils in German schools, is not an adequate excuse: German-speaking Austria—yes, easy-going Austria—came tenth in the reading tests, although it has a similar proportion of pupils of foreign descent.

What else might be wrong? Money? Germany's spending per pupil is a bit below the OECD average. But so is Britain's and British pupils, to the surprise of many there, figured in the top ten in all the tests.

The organisation of schooling, then? That would be hard to judge. Education is the responsibility of the country's 16 distinct *Länder* (states), and the various systems they use range from the highly selective to the fully comprehensive.

There is more of a clue, perhaps, to be found in the teaching force itself. Germany's school-teachers are relatively well paid, but they are too few: Germany has one of the highest pupil-teacher ratios among OECD countries, and in many subjects an acute shortage of teachers. Nor are new ones flocking in: two-fifths of all teachers are over 50. One in three admits to feeling “burnt out”; nearly three-quarters take early retirement on health grounds. Inevitably, the quality of teaching suffers.

Other explanations abound. One is the German zeal for rote learning, rather than for teaching children to think for themselves. Another is the inadequate support given to weaker students, and the requirement that any pupil who gets poor marks in just two subjects has to repeat the whole year. Most of the other 15-year-old pupils involved in the OECD study were all in the same grade, having gone up with their contemporaries as a group; the German 15-year-olds spanned four grades, because so many had had to repeat a year or more.

Some people blame Germany's compressed school day, which starts at 8am and usually ends at 1.30pm or 2pm. Many parents would like a later start and a longer day. Some *Länder* are trying out all-day schooling, but so far only on a small scale. The big need, runs another argument, is for more free kindergarten places, to help, in particular, children from non-German-speaking immigrant families. At the top of the scale, it has long been argued that more pupils should be encouraged to go on to higher

education. At present, only 28% do so, compared with an OECD average of 45%—and only 16% emerge (typically, some six years later) with a degree.

Since the report was published last week, Germans have been racking their brains over all these questions and more. No one yet has the answers. But many Germans are already convinced that nothing short of a “cultural revolution” throughout the education system is now required.

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Norway's state sector

Slowly to market

Dec 13th 2001 | OSLO
From The Economist print edition

Norway's new centre-right government cannot rush to privatise

ON NEW year's day, almost every hospital in Norway will be nationalised. By Kjell Magne Bondevik's new, right-leaning government? Yes: the 19 counties' public hospitals are hugely overspent. So the centre, through five regional boards, will take control. And private hospitals? They hardly exist—and hardly anyone, left or right, wants more of them. There, in a nutshell, is the dilemma of the country's far-reaching welfare state and, more widely, of its public sector.

And that's just the big ones

	Business	Govt. stake, %	Turnover 2000, $bn
Statoil	Oil	82	26.18
Norsk Hydro	*	45	17.82
Telenor	Telecoms	78	4.23
Den norske Bank	Banking	47	1.47†
NSB	Railways	100	0.64
Statkraft	Power gen.	100	0.60

*Oil, gas, fertilisers, chemicals, aluminium, etc
†Interest and other operating income
Sources: Company reports; *Dagens Næringsliv*

Both are large. Almost all health care and education, including 80% of the running costs of church schools, is state-provided. So are pensions, water, electricity, roads, railways and fixed-line telecoms. Beyond such traditionally public services, the state dominates in oil and gas, and has big stakes in manufacturing: it owns 45% of the country's industrial giant, Norsk Hydro (oil, gas, chemicals, fertilisers, aluminium) and 47% of Den norske Bank, the biggest commercial bank. Overall, the state holds about 40%, by value, of the local stockmarket. Plus $65 billion—roughly $14,500 per Norwegian—in the Petroleum Fund, a stockpile of recent years of earnings from North Sea oil, put aside for the day when the oil runs out. One worker in three, roughly, is in the public domain.

So how does the new government begin to let in the market? The Labour-led government voted out in September had already sold about a fifth of both Statoil and Telenor, its till then 100%-state oil and telecoms businesses. Yet though the new team indeed plans further sales, the issue is not so much where and how, as how far and fast it wants to go and, politically or economically, is able to.

Why bother? After all, “state capitalism has worked pretty well,” admits Victor D. Norman, a firmly pro-market minister plucked from the rectorship of a business school. State businesses have for years been told to act commercially—even the post office is now being pushed that way—and for the most part they do. True, the government appoints board members, but these days for their business qualities, not as political pals. “It is hard to think of a country where the state has been so passive a stakeholder,” says Eivind Reiten, a former energy minister who is now the chief executive of Norsk Hydro.

The case for change, broadly accepted by right and left, is not to let in the market, but a new facet of it: private owners. The managers may be fine, but any management needs vigilant shareholders; and there is confusion, says Mr Norman, if that means the state. It may act as owner, but it is also the government; its businesses, and others, will wonder which hat it is wearing. Equally, its businesses want foreigners to see them as such, not state tools. That was why Labour sold chunks of Statoil and Telenor. Note the pragmatism of these reasons: just as Norway has few pure statists, it has few Thatcherites. Current plans for private-public partnerships to build and operate some new roads are broadly bipartisan. There is no wild dispute even over services such as schools and hospitals: you can set up private ones, just don't expect crowds of customers.

The new team is readying its businesses for sell-offs, and wants parliament to let it cut its stake to a blocking 33%-plus in any of them. Yet it cannot sell fast. For one thing, Norway is short of private capital. The state is rich, but its over-taxed citizens have no huge pension funds to buy ex-state shares. This may alter. Pension reform is one of the big tasks ahead, and many ideas are afloat (and being studied, typically, by a commission under a Labour chairman). But none—short of simply handing out shares in the state's holdings to individual Norwegians—would allow full-scale privatisations overnight.

Really not? Why not just put the shares up for sale and see who buys? Enter the real obstacle: most Norwegians, right or left, hate the idea of foreigners taking over Norway's natural resources. When Norsk Hydro in 1999 wanted to buy a sizeable oil company, it was allowed to issue new shares to pay for it, so cutting the state's stake below 50%. Parliament urged the government to buy more shares, so as to get above that level again—not to ensure public ownership, however, but Norwegian ownership.

That's why the Labour government this year used Den norske Bank to block a Finnish bid for a big Norwegian insurer. It is why even Mr Bondevik's rightish team talks of keeping 33%-plus, not simply selling out—and why Labour now argues for more in some cases, saying that a blocking third may be fine in law but not in the real world, if other holders back a takeover.

For an ironic example, take the central state's 100%-owned power generator, Statkraft. It happily buys chunks of local ones—there are 300, mostly locally owned. But ask its boss, Baard Mikkelsen, to imagine that it itself, tiny by world standards for its industry, were opened to a takeover. Some foreign giant would put in a bid next day, he says. Many stalwartly pro-market Norwegians would share his dislike of that. There are only 4.5m of them, and having twice voted to keep their country independent of the European Union, they have little mind to sit and watch global market forces gobble it up.

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Turkey

Rays of light

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For the first time in a year, Turks are seeing some flickers of hope

Reuters

Still the best currency?

A RARE shaft of light has penetrated the gloom which for the past year has shrouded Turkey. The economy, crippled by a recession that followed a banking crisis and currency crash last February, is showing hints of recovery. After nearly four decades of bickering or non-communication, Turkish-Cypriots and Greek-Cypriots are at least back to talking of some kind of deal to reunite their divided island. And just as encouragingly, Turkey has agreed to drop its threat to use its veto in NATO to prevent close co-operation with the EU's proposed rapid-reaction force, after being assured that the force would not be used against it in a conflict with an EU country (read Greece), or in any fight in Turkey's part of the world without Turkey being consulted.

What has caused this startling change of mood? On the economic front, Turkey's odd coalition government of fierce nationalists and mild leftists had to swallow the bitter medicine prescribed by the IMF as part of a rescue arrangement worth $19 billion, or face a complete collapse of the bank system. The IMF's executive director for Europe, Willy Kiekens, last week praised the Turks for their recent efforts to reform. As a result, he has been negotiating a fresh loan, worth $10 billion, to help the government service the huge domestic debts that had piled up since it sought to bail out the banks after the February crash.

In any case, the capital share of state-owned banks as a proportion of the total has shrunk from 40% to barely a fifth. As new rules about openness bite, politicians should find it much harder to borrow from state banks as their age-old means of dispensing patronage.

Buoyed by promises of still more cash from the IMF, shares on the battered Istanbul stock exchange have gone up by 23% in the past month, while the Turkish lira, which shed more than half its value after the crisis, has risen by almost 10%. It all amounts to “an economic revolution”, writes Metin Munir, a prominent financial commentator in a mass-circulation daily newspaper, *Sabah*.

This burst of confidence is caused in part by Turkey's growing importance in western eyes since September 11th. After becoming the first Muslim country to offer troops to the American-led campaign in Afghanistan, Turkey has even changed its tune on Iraq: it has indicated that, if America takes on Saddam Hussein, Turkey will not object. “We should go after terrorists wherever they are,” said Ismail Cem, the foreign minister, when Colin Powell, the American secretary of state, visited Ankara last week. For good measure, the Turks kicked out Iraq's ambassador, supposedly for links with Osama bin Laden.

The Americans are pleased too by the apparent flexibility of the Turkish-Cypriot leader, Rauf Denktash, who has dropped his long-standing demand that his bit of Cyprus should be recognised as an independent entity before any peace talks with his Greek-Cypriot equivalent. “Turkey has realised it cannot join the EU until Cyprus is solved—and that's highly encouraging,” says a European ambassador.

But the shadows still lurk. Bulent Ecevit, the prime minister, who is 76, sounds shaky. One newspaper says that he left a recent cabinet meeting without putting his shoes back on. If he were to resign, his awkward coalition might collapse. And if Tayyip Erdogan, the Islamist-minded former mayor of Istanbul, won an election, as many pollsters predict, the IMF, which he rails against, might just change its mind.

Moreover, many of the country's 12m-odd Kurds (nearly a fifth of the population) go on grumbling. Curbs

on the Kurdish language in education and broadcasting are to be loosened, as part of an effort to polish up Turkey's democratic credentials. But the changes have yet to be felt. Security forces in the mainly Kurdish city of Diyarbakir, in the south-east, recently banned a local radio station, confiscated its equipment and prosecuted its owner for airing Kurdish love songs. Soon after, police raided the offices of some Kurdish-language publications and arrested their owners, besides scores of officials from the pro-Kurdish People's Democracy Party.

The crackdown has provoked threats of renewed violence from members of the separatist Kurdistan Workers' Party, who have stuck to a truce in their 15-year-long battle for independence since their leader, Abdullah Ocalan, was captured nearly three years ago. Another Kurdish upheaval is the last thing that Turkey needs.

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The Kremlin

Old versus new

Dec 13th 2001 | MOSCOW
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Civil war in President Putin's camp

AP

Old broom? New guard? Old Russia

THE Kremlin runs Russia. But who runs the Kremlin? Around President Vladimir Putin, the snowballs are flying in a battle for power and money.

On one side is the “family”, mostly well-connected leftovers from the Yeltsin era. Notable among them are the head of Mr Putin's administration, Alexander Voloshin, and the prime minister, Mikhail Kasyanov, but also included are the central-bank chief, the top prosecutor and other worthies. On the other side are the *siloviki,* the hard men, brought in by Mr Putin, mostly, like him, from St Petersburg, and with KGB or similar backgrounds. They include Sergei Stepashin, who runs the Audit Chamber, the state's main anti-corruption watchdog, and Nikolai Patrushev, head of the internal security service, the FSB.

Both sides claim the argument is about how to run Russia. The old guard talk experience and stability. The newcomers say they want a stronger state and less crookery. Cynics say the Yeltsin-era lot are really just trying to hang on to their juicy, ill-gotten assets and incomes, whereas the newcomers just want to get their hands on the loot, and the sooner the better.

The weapons in this struggle are blackmail, feigned illness (which can keep you out of jail), the legal system, and accusations of banditry and incipient totalitarianism. Oddly, both sides more or less count on the president's support. The feud has been simmering since Mr Putin took power. Now it is becoming open war.

One battle is over jobs. The railways minister, Nikolai Aksyonenko, a “family” member, suffered the indignity of a late-night visit from anti-corruption investigators during his granddaughter's birthday party. Exaggeratedly, his side claimed to find echoes of Stalin's purges in this. The rumour mill has been hard at work. A television station owned by a banking tycoon close to Mr Putin reported that Mr Voloshin, an efficient administrator who seemed to have settled down with the new regime, had been dismissed. The tale was widely repeated in other media, in what looked suspiciously like planted (and paid-for) articles. So far, in fact, Mr Voloshin remains in place.

Business is a second battlefield. A would-be putsch at Gazprom, Russia's biggest (and grossly mismanaged) company, failed when Mr Putin stepped in, reluctantly, to keep his newly appointed man in the top job, where he had been making little headway. Another row concerns the customs service (see article). Its bosses are mainly people from the Yeltsin era. But two now face corruption charges. The *siloviki* want full control.

Some of the old guard are saving their own skins by turning on former friends: the prosecutor's office, a “family” bastion that the new men have tried and failed to capture, has recently given zealous support to Mr Stepashin's sleaze-hunts.

Mr Putin has shown he can act fast and toughly when he wants. But he has mostly stayed out of the fight. He may be biding his time. Or maybe, understandably, he just finds both camps unappealing.

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The EU arrest warrant

Curbing crime—and sovereignty

Dec 13th 2001 | BRUSSELS
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The proposed EU-wide arrest warrant raises issues that go wider than crime

THIS week's agreement on a common arrest warrant for the European Union is a big step towards EU integration. Since September 11th, the Union wants to be seen to be doing more to fight cross-border crime. So its members have dropped long-standing reservations about allowing each other more power to enforce cross-border arrests and extraditions. Italy, the last country to hold out, gave in this week.

The 32 crimes to be covered by the warrant go well beyond terrorism. They include fraud and embezzlement, even “racism and xenophobia”. From 2004, when the legislation should be in place across the EU, people accused of such offences in one EU country could be arrested and deported to it by another with no need for lengthy extradition procedures. The only proviso is that the offence must carry a potential sentence of three years in prison.

The agreement marks a departure in several ways. EU countries will enforce arrest warrants even for offences that are not crimes under their own law. They will extradite their own citizens like anyone else. Portugal, Greece, Austria and perhaps Italy will have to amend their constitutions.

This shift towards a common European legal system is worrying both libertarians and nationalists. Civil-rights groups fear that people extradited from one EU country to another may lack adequate legal safeguards. Italy's Eurosceptical Northern League has raised the spectre of a Brussels-based Gestapo rampaging across Europe. Britain's *Daily Mail* greeted the agreement with a front-page headline proclaiming: “Surrender—How Britain gave up 1,000 years of legal sovereignty to Europe's judges and police.” British Eurosceptics are particularly anxious lest defining xenophobia as a crime might inhibit free speech. European officials respond that a “common definition” of xenophobia is intended to nail neo-fascism rather than to prevent the populist bashing of foreigners.

British officials argue that guardians of national sovereignty should actually be pleased with agreement on a common arrest warrant, since the fundamental principle behind it is mutual recognition of distinct national legal systems. This, they say, is preferable to moves towards a single, harmonised EU legal system, with all its federalist implications. Arguably so; but agreement on a common arrest warrant does not preclude further legal harmonisation at a later date.

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Charlemagne

Italy oddly at odds with Europe

Dec 13th 2001
From The Economist print edition

Silvio Berlusconi's hostility to the EU-wide arrest warrant may have changed Italy's attitude to Europe

THE fact that Italy's government angrily said no last week to a proposed EU-wide arrest warrant and then reluctantly said yes just five days later is beside the point. What is astonishing, in the Italian context, is the change of mood: a love affair that has lasted nearly half a century has suddenly, if you believe what ministers have been saying, turned sour. Italians are confused. What, they are asking, is the government's policy toward Europe? Who is in charge? Has something truly changed?

“Europe” has long been Italy's sacred cow, something that no mainstream politician has ever dared to challenge or criticise. As a mark of pride, every Italian government ritually reminds its partners abroad that Italy was a founding signatory of the treaty that ushered in what became the European Community, and Rome its birthplace. No matter that Italians have not always been fastidious about implementing European directives or that their governments have occasionally been dragged before Europe's Court of Justice to be scolded and even fined. Italians have loved Europe—so much so that four years ago they merrily accepted an extra “tax for Europe” (an unthinkable notion in most other EU countries). This was to allow them to qualify for the first intake into the single currency, an achievement many pundits considered impossible given the country's past extravagances. Well, *arrivederci* to such uncritical love. Europe, for the first time in Italy, has become contentious. Politicians are saying rude things about Brussels. Ministers are even echoing British Eurosceptics by talking in bleak tones of a monstrous European “superstate”. What is going on?

Peering through a haze of anguished speechifying, at least four different “agendas for Europe” have been visible within the Italian government alone. The most solid European in Silvio Berlusconi's cabinet is his foreign minister, Renato Ruggiero. A stocky, jovial former ambassador who has previously been a trade minister, a roving statesman for Fiat (he is still widely regarded as Gianni Agnelli's man in government) and, most recently, the head of the World Trade Organisation, he belongs to the old school. Integrating into Europe, he thinks, is Italy's best and only bet. If tiffs arise, like the one over the warrant, you should compromise; never brag or shout. His hand was evident in this week's warrant-saving deal. Had he failed to do the deal, he might well have walked out of the government and back, perhaps, into Mr Agnelli's employ (Fiat needs a bit of help).

The opposite outcome, with Italy demanding to “opt out” (British- or Danish-style) from an EU-wide judicial area would, however, have thrilled another leading figure in Mr Berlusconi's government: Umberto Bossi, the founder and leader of the once-separatist Northern League. Mr Bossi is an unhappy minister for reforms, for he has so far proved unable to introduce any. During the election campaign he piped down. He may feel overshadowed by Mr Berlusconi's huge wealth, his chutzpah and his access to television (since the prime minister owns or controls most of it). But the arrest-warrant row got Mr Bossi galloping, like Don Quixote without the chivalry, full tilt against the EU. Europe, he declared, is “*forcolandia*” (a land of gallows), run by big business and freemasons, and infested with paedophiles.

Then up cantered Roberto Castelli, the justice minister, a Sancho Panza to Mr Bossi. An engineer by profession, he is out of his depth. Last week in Brussels, in next to no time, he managed to have Italy isolated by his 14 counterparts over the warrant. Humiliated? Not a bit of it, says Mr Castelli: everybody, from Lisbon to Stockholm, now knows that Italians care about individual liberties. In truth, along with Mr Bossi, he simply misread the mood in Europe since September 11th.

The man in the Italian middle, it seems, was Giulio Tremonti, Mr Berlusconi's finance minister. He is a genuine pro-marketeer and has liberal (even, some would say, anarchic) instincts. One of his achievements, in securing victory for Mr Berlusconi's coalition of the right in May, was to bring Mr Bossi

on-side. But it was quite a surprise, all the same, when this week he stood by his Northern League ally—citing libertarian reasons. In a philosophical exchange with *La Stampa*, a newspaper based in the northern city of Turin, he too castigated the arrest-warrant idea. “Europe”, he intoned, “is going back to the days before the Enlightenment.” Switzerland, he added, was the “black hole” in terms of European law, not Italy. Quoting St Augustine, he gravely accused Europe of becoming “a new church”. It is unlikely that canny Mr Tremonti believes this. But he may like the idea of acting as a bridge between Mr Bossi and Mr Berlusconi, and perhaps even of taking the top job one day.

And the great man himself?

Mr Berlusconi, in all probability, has no real vision of Europe. His instincts are largely tactical. He admits he knows little of abroad, hoping simply to charm his fellow prime ministers as he has charmed the voters at home. Yet he truly wants to be loved and admired beyond the Alps, and be welcomed at the big boys' table. So why did he risk annoying them by rejecting an idea that they had all eagerly accepted (and that had been sponsored by his Spanish friend, Jose Maria Aznar)? Some, of course, say it was purely to protect himself from investigations into his murky financial dealings by prosecutors outside Italy. Moreover, he certainly detests Italian magistrates, insisting that their continuing efforts to convict him of crimes of dishonesty are driven entirely by politics. On such matters, which still threaten to spoil everything for him, Mr Berlusconi may have become obsessive. Perhaps he lost his cool. If so, it was Mr Ruggiero who steadied him.

The row over the warrant has indeed changed the temperature—and the game. Europe, for the first time in Italy, has become a political football. Mr Berlusconi may not be sure, right now, where he ought to kick it. But it is likely to bounce around in Roman courtyards (if not courts) for quite a while yet.

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Race and poverty

Down and out up north

Dec 13th 2001
From The Economist print edition

Reuters

Race divides troubled northern cities. Poverty and unemployment unite them

Get article background

PERHAPS Britain had become a little complacent about race in recent years. It had never had race riots on the scale of America's, and hadn't had a serious race-related disturbance in years. It had never had a far right party as frightening as those in some European countries, and what there was had shrivelled. Things seemed to be going rather well.

The riots that shook Bradford, Burnley, Oldham and Leeds this summer were therefore a shock. Journalists and civil servants followed in the wake of the violence and returned with the news that communal divisions and racial hatred were alive and well. So Britain now sees itself as a shockingly segregated society.

This view is, of course, as simplistic as the previous one. British society is not uniformly segregated, any more than immigrants are a uniform bunch. West Indians came to Britain in the 1950s and 1960s, mostly to work in public services such as the health service and the buses. Pakistanis and Bangladeshis were imported as low-skilled workers for the textile industry. East African Asians were thrown out of Uganda and Kenya because they were so prosperous, and many re-created their prosperity in Britain. These different communities all behave differently.

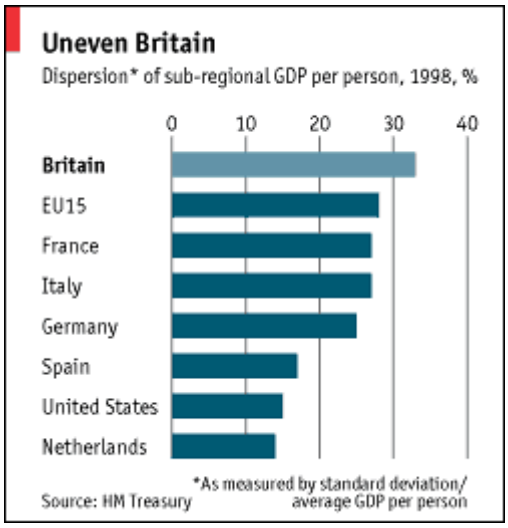
If intermarriage is the highest expression of integration, some immigrants are highly integrated. You can see it on the streets of south London, where the babies are many shades of brown. Among West Indian-origin men born in Britain, half marry a white woman, and 30% of West Indian-origin women born in Britain marry a white man. Among Indians and East African-origin Asians, 19% of British-born men and 10% of British-born women marry white partners. Hardly any Pakistanis and Bangladeshis do.

The economic prospects for the Pakistanis and Bangladeshis are different to those of other groups, too. They are less qualified, and less employed, than any other ethnic group. In fact, the people they have most in common with are the people from whom they are so sharply divided—the poor whites on the estates next door.

In Glodwick in Oldham, a mainly Asian area, unemployment is 40%. In Manningham in Bradford, which also has a high Asian population, it is 38%. But there's nothing particularly Asian about this. Poor white wards have levels nearly as high. And, further south, in Leicester, the British city with the highest proportion of Asian-origin people, the ward with the highest unemployment rate (12.3%) is 97% white,

while the ward with the highest Asian population (67%) has 6.7% unemployed. There were no riots in Leicester.

If poverty is the breeding ground for racial tension, then the signs are bad for northern England. A recent Treasury report conceded that the wealth gap between the rich south-east and the poor north was larger than the regional divide in any other European country (see chart).



The worst-qualified suffer most from the prosperity gap. A paper by Esra Erdem and Andrew Glyn in “The State of Working Britain”, a report published last month by the London School of Economics, showed how the gap affects the inactivity rate—unemployment plus those who have opted out of the labour market—of low-skilled people. The inactivity rate among the worst-qualified in the south-east is 30%; in Merseyside it is 60%. The disparity is higher in Britain than in Germany, France or America. If you're low-skilled in one of Britain's gloomier regions, forget it.

The prosperity gulf seems to be getting wider. Robert Huggins, who runs an economic consultancy in Cardiff, says that on a composite measure of wealth creation, incomes, employment, and business density, the gap between Britain's three richest regions—London, the south-east and East Anglia—and the three poorest—the north-east, Wales, Yorkshire and Humberside—has grown by 30% since 1997.

Economic theory says that, after the closure of traditional industries such as textiles, ship-building and coal-mining in the 1980s which hit the north hard and opened the regional divide, market forces should cause the gap to close again. The fact that this is not happening in Britain, says the Treasury, shows that the market cannot be working properly.

Why not? Probably in part because of some factors which get in the way of the operation of the market. Lots of poor people live in social housing. Social housing is in short supply in high-growth areas. For people who rely on social housing, moving from a depressed area to a prosperous one is hard.

Nor does the private housing market make it easy. Britain's economy is highly centralised on London and the south-east. High house prices in those areas make it virtually impossible for poor people from other regions to move there, even if they own their own property. The price of a house in some areas of Bradford won't buy you a garage in the better bits of London.

In the past, wages in many industries were set by national negotiations. That is less true these days—except in the public sector, which is still a huge employer. Steve Fothergill, a regional economics researcher at Sheffield Hallam University, points out that national pay-bargaining structures prevent the wage levels from falling in poorer areas, and thus discourage growth in high-unemployment areas.

The government is not about to revert to 1960s-style regional policies when large subsidies were paid for setting up factories in depressed regions. Instead of shifting jobs around the country, it wants to encourage the formation of new businesses and to help existing ones expand.

But the record on such efforts is not great. Improving transport links might do more. Paul Convery, a director of Inclusion, a social policy think-tank, says there is evidence that people in places such as Burnley are becoming more willing to travel to Manchester for work. “But the transport infrastructure is so grim that even relatively short journeys of 15-20 miles are severe obstacles,” he says.

Better education would help. Educational achievement levels are lower in northern England than in the rest of Britain, and lowest of all amongst school-leavers of Pakistani and Bangladeshi origin. Encouraging them to mix with white kids won't help if they all leave school without enough qualifications to get a job.

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Paedophiles

Sarah's law?

Dec 13th 2001
From The Economist print edition

Britain already has tough laws to monitor paedophiles; but the risk that a child may be murdered can never be eliminated

Roy Whiting, convicted child-murderer

THE death of any child is tragic; the murder of a child by a stranger is always peculiarly appalling. Even so, the public response to the murder of Sarah Payne, an eight-year-old abducted and killed last year while playing with her siblings in the Sussex countryside, was extraordinary. The ensuing debate about how to protect children from predatory adults was revived this week, when Roy Whiting was sentenced to life in prison for her murder; the judge revealed that he had abducted and abused another child in 1995.

Understandably, Mr and Mrs Payne and their many supporters want something to be done. In particular, they want the government to pass a law enabling parents to be notified about convicted paedophiles living in their vicinity. Their efforts were lent dubious assistance by the *News of the World*, a tabloid newspaper, which last year helpfully pledged to publicise the whereabouts of all Britain's paedophiles.

Its campaign was curtailed by a witch-hunt of sex-offenders (and one paediatrician apparently mistaken for a paedophile) which confirmed the fears of policemen and probation officers who argue that such a law would make supervising and rehabilitating sex-offenders harder. Likewise, critics of “Megan's Law”, the American model for the proposed “Sarah's Law”, argue persuasively that the law protects politicians from the public more than it protects the public from paedophiles.

Another questionable proposal—to tell jurors such as those in the Payne case about the prior convictions of defendants—could facilitate sloppy policing. A response to the furore more likely to appeal to ministers could be to imprison paedophiles until the experts are convinced that they no longer pose a threat—though whether, in a liberal society, people should be punished for a proclivity is a thorny question. The government may not like to say so, but it is ultimately obliged to consider the rights of the paedophiles as well as those of their potential victims.

The truth is that Britain already has tough laws to monitor and restrain paedophiles. They are obliged to register with the police, who can already inform some relevant parties—schools, employers, and so on—about the risk they pose. Better resources to rehabilitate sex offenders in prison, and supervise them outside it, would do more good than demagogic new laws.

And, fortunately, the infamy of crimes such as Mr Whiting's wildly exceeds their frequency. The murder of children by strangers—around half a dozen of which occur in England and Wales every year—is vanishingly rare; most child-killing, like most child abuse, is perpetrated, less spectacularly, by relatives. So the danger posed by criminals such as Mr Whiting is small. But it can never be eliminated.

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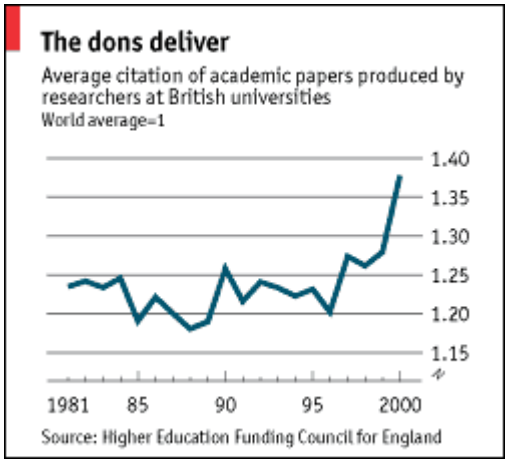
University research

British eggheads rule

Dec 13th 2001
From The Economist print edition

The quality of university research has shot up



ON DECEMBER 14th, university researchers were due to find out what their colleagues really thought about them, with the publication of the results of a five-yearly assessment of research. Since money depends on the results, everybody is watching keenly.

The results divide research into what is world-class and what is not. They show that British research, ranked among the best in the world, has further improved since it was last examined. More than half of researchers are based in departments containing work of international excellence, compared with a third in 1996.

There are no surprises at the top of the table. Cambridge ranks first, Imperial College of Science, Technology and Medicine is second, Oxford is third and the London School of Economics is fourth.

Britain now ranks first in the world in terms of the numbers of publications and citations it generates per dollar spent on research. Six years ago, British-based researchers wrote 11% of the most frequently cited papers; that figure has since risen to 18%. Despite such tributes from their peers, many academics still argue that more does not necessarily mean better. Academics may rush work into print merely to meet the artificial deadline of the five-year cycle, rather than spend longer producing the sort of great magnum opus that used to distinguish disciplines such as history and English.

Part of the improved performance is due to universities playing games to maximise their research income. Universities included only their top researchers in this year's exercise, in order to keep their average marks up.

Even so, there is no doubt that much of the improvement is genuine. After the 1996 exercise, universities were stung by criticism that British judges were deeming university departments to be internationally excellent without canvassing opinion from outside Britain. This time, international opinion was sought and, in all but 3% of cases, it confirmed the judgment of the British panels.

The dramatic improvement has taken the government by surprise. It uses the results to determine how it spends £1.4 billion ($2 billion) each year, discriminating between excellent research, which it rewards, and less impressive work, which it does not. The bill for rewarding the improvement is £200m and no money has been set aside for paying it. Margaret Hodge, the minister for higher education, has told universities that they must live within the original budget.

The Higher Education Funding Council for England—the body through which government allocates university funding—now has to decide whether to delay implementing the results while campaigning for more money or whether to cut funds to areas which are nationally, rather than internationally, excellent. The chief executive of the funding council, Howard Newby, favours the former.

That university research has flourished during a time when the public funding for higher education has not kept pace with the expansion in student numbers is a testament to the importance of research to universities. A separate study has found that universities use the money which overseas students pay in tuition fees to subsidise research. It is no coincidence that those producing the best research also have a high proportion of overseas students. Kudos and cash go hand in hand.

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Pet theories

Having kittens

Dec 13th 2001
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Cats and dogs fight it out for prime pet position

THE steadily growing number of single-person households in Britain has raised plenty of troubling issues—how to build enough dwellings to accommodate them, what to do about the decline in traditional family cohesion—to keep planners and sociologists busy. But one as yet unstudied side-effect of this social trend appears to be an explosion in the cat population.

The Pet Food Manufacturers' Association reckons that the number of dogs has declined from a peak of 7.4m in 1990 to 6.5m now. Meanwhile the domestic cat population has risen steadily, overtaking dog numbers in 1993 to stand now at about 8m, twice as many as there were in 1965. Changing life-styles, more than anything else, are responsible for this. More single-person households and more married women at work means that fewer households are able to give a dog the walks and other attention it needs. Cats, on the other hand, apart from daily feeding, can be left pretty much to their own devices.

Which also means that they sometimes wander off in search of a better place to stay if the mood takes them. This causes another problem: feral cats. As cats are harder to round up than dogs, and breed prolifically—a pair can produce ten offspring a year—large colonies of 80 or so cats hiding out in disused buildings are increasingly common. While the Royal Society for the Prevention of Cruelty to Animals and the Cat Protection League re-house about 125,000 stray or unwanted cats a year, the League guesses that there may be about 1.2m feral cats in Britain.

If they are not a nuisance, the animal charities neuter the ones they can catch and then leave them alone. Animal-lovers are pleased. Bird-lovers are not. They blame cats for the sharp decline in the number of small birds in Britain. The League, however, has an idea for making feral cats socially useful. It tries to persuade farmers and garden centres to take them on as environmentally-friendly rat-catchers. A bunch of neutered, feral cats could well be an efficient way of controlling a potentially nastier plague of rats and mice.

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Planning

Forget the fish

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Proposed planning reforms should make the system work faster

FOR months now, ministers have been blaming Britain's archaic and expensive planning laws for many of the country's ills, from high house prices to poor productivity. Lord Falconer, a close ally of the prime minister, describes the planning system as “a quagmire”. It is certainly a lawyer's paradise. The national planning guidance alone runs to 800 pages.

This week the government unveiled its proposals for reform claiming that they represented the biggest shake-up in the planning system for half a century. The green paper, a consultative document, hardly lives up to the hype. But it does contain a number of sensible proposals for reforming a system which deals with 150,000 business and 300,000 domestic planning applications each year.

The new proposals include a simpler system of planning for development and more money for compensation for land that is compulsorily purchased. The government also wants developers to be able to build more easily in designated business zones. The process for planning appeals is to be speeded up. All these measures should make the system work a little faster.

The case for change is hard to deny. The chancellor, Gordon Brown, is convinced that Britain's poor productivity performance is in part due to its restrictive planning system. That was the thesis of a hefty report published by McKinsey's consultants three years ago which argued that every British household could be £2,500 a year better off if Britain was able to match American levels of productivity. A report which recently emerged from the Department of Environment Transport and the Regions estimated that the cost of planning delays to business was at least £600m a year. Currently more than half of all commercial planning applications take longer than two months to be decided.

For large projects, planning sometimes borders on the absurd. The inquiry into Heathrow's Terminal Five spent two days discussing whether some fish displaced by the proposed terminal would or would not be able to swim up a culvert. No wonder the inquiry occupied 33 barristers, cost £100m and took four years to complete. Even much smaller projects are subject to lengthy delay. Terry Leahy, chief executive of Tesco, complained to a Confederation of British Industry conference recently, “I know Rome wasn't built in a day, but why does it take four years to get a positive decision on one moderately-sized inner city store?”

A project to build a new freight railway, financed solely by private investment, from Liverpool via Manchester, Sheffield and London to the Channel Tunnel has been mired in planning problems for more than a decade. Andrew Gritten, chairman of Central Railway, says this scheme would take 3m lorry journeys a year off the roads. But without the government's backing, it has little chance of getting through Parliament, let alone surviving a public inquiry.

The government is to publish a document next week advocating new parliamentary procedures for major projects. Ministers believe that delays could be cut if the government were to set out its views in advance of a public inquiry. These would then be subject to parliamentary debate and approval. The planning system could thus deal with local issues rather than issues of principle.

Environmental and other lobby groups say they will resist such a change, which they see as short-circuiting democratic accountability. Certainly, the faster things happen, the worse it will be for them. It took more than a quarter of a century and three public inquiries before the bulldozers could start ploughing through beautiful Twyford Down to build a bitterly-fought extension to the M3 motorway near Winchester. In future, Swampy and his friends will have a much harder task opposing big new developments.

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National libraries

Let's hear it for the tortoise

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Who builds fast does not always build best

THE French are the masters of "*grands projets*". They have the ruthlessness, national pride and willingness to spend that are needed for great public works. The British, on the other hand, are usually dismissed as too mean, bogged down by regulations and lacking in vision, to build anything worthwhile. But occasionally the bulldog triumphs.

Take, for example, that grandest of *grands projets*, the national library. The Bibliothèque Nationale de France, fast-tracked by President Mitterrand, was planned and built in less than a decade. With its four 80-metre-high glass towers, designed to resemble open books, the library was hailed as a wonder of design and construction when it opened in 1998. Its 11m books, protected by automatic climate control, were designed to be instantly accessible, with the help of computerised, automatic loading trains running on miles of track. All this, for FFr 8 billion (£861m), was hailed as tangible evidence that the glory of France was alive and well.

The British Library, which cost a third less, became a symbol of national incompetence. First conceived in 1962, it ran into trouble from the start. After three decades of bitter controversy, planning delays and money problems, the new red-brick library, designed by Colin St John Wilson, finally opened for business in 1997. The reviews, given its troubled history, were predictably mixed. The Prince of Wales, who had unveiled the foundation stone, compared it to "an academy for secret police".

Matters look different today. The British Library is widely acknowledged as one of London's best modern buildings, a triumph of design over adversity. Those who work there sing its praises. The Bibliothèque Nationale, by contrast, has become notorious for its poor design and even worse construction. Its high technology retrieval system has proved a nightmare. Its glass construction bakes books in summer. Its freezing winter temperatures have provoked its 3,000 staff to strike. Conditions became so intolerable that soon after it opened several hundred frustrated academics stormed a reading room trampling library staff under foot. Dismissed by three eminent French professors as a "sinister farce", *la grande bibliothèque* proves that victory does not always go to the swiftest.

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Restaurants

Famine in London

Dec 13th 2001
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Central London's restaurants are in trouble, but those in less fashionable locations are flourishing

The lunchtime rush

CHRIS BODKER, chairman of Image Restaurants, epitomises the current state of the British restaurant business. Formerly a banker with S.G. Warburg, he represents the large, external and unprecedented financial interest that has flooded into this unpredictable trade over the past eight years. Of the six restaurants in his group, he observes with some amazement and relief that the three outside the West End are outperforming those in central London. And, as a relative newcomer to this world, Mr Bodker is, like many other restaurateurs, having to manage in a recession for the very first time.

With timing that now only makes him laugh, Mr Bodker has also spent the last 18 months supervising his biggest project to date, the £2.8m conversion of a site at the cusp of Soho and Covent Garden into West Street, two floors of restaurant and three of hotel bedrooms which opened for business on September 19th. It was not like previous openings. “Within two weeks of opening, business in the other restaurants just took off,” says Mr Bodker, “but at West Street it has been like pushing into a great headwind.”

The past three months have confirmed a couple of trends that were already evident before September 11th. For many, sales in the first half of the year were already slowing down. One supplier to the capital's top restaurants reported that his August turnover was 50% down on the previous year. The view that there are too many restaurants inside the M25 explains why several larger groups, such as Groupe Chez Gérard, Bank, Conran Restaurants and Gaucho Grill, had already begun to focus their expansion on sites in provincial cities. Hence the rash of new openings earlier this year in Manchester, Leeds, Edinburgh and Bristol.

But the squeeze on corporate expense accounts, particularly in the extravagant advertising world, and the expansion of upmarket sandwich and coffee bars such as Pret A Manger, Cafe Nero, EAT and Starbucks have also seriously affected lunchtime trade. Whilst a busy restaurant may serve the same number of tables today, the size of the lunchtime booking has been reduced from four or three to two to cut costs. Individuals are responding by sticking to the restaurants they know best. Getting a table at The Ivy remains as difficult as ever.

For some restaurants, however, business has actually improved since September 11th, most notably cosy joints in residential areas where customers feel safe, because they are not too far from home, and where they can be nurtured by comforting food in comfortable surroundings. Rupert Clevely has benefited from this trend. Over the past five years his company, Geronimo Inns, has taken over nine London pubs, gentrified them and installed good chefs, often itinerant antipodeans. They are concentrating on main courses at under £10. Since September 11th, this combination of convenience, comfort and value has resulted in a real sales increase of 11% on the previous year.

Mr Clevely's gain is central London's loss. Many of his customers are people who used to stay in town after a day at work, but instead are heading home. And central London is also missing the American visitors who brought valued business before and after theatres and on Sunday evenings. “Sunday evenings at The Avenue used to be smart and high-spend,” Mr Bodker explains, “with Americans who had flown in for the week and used to stay at The Ritz, Dukes or The Stafford. Now they are not travelling, and Sunday evenings are down 50%.”

Mr Bodker, like many other restaurateurs, remains essentially optimistic—a prerequisite of the profession. This recession, he says, is different to that of the early 1990s. The big difference is low interest rates. But beneath this optimism lies concern for the first half of next year. Christmas bookings are healthy but many restaurateurs are reporting that they are noticeably different from a year ago: individual numbers are down and customers are prone to trade down the menu and wine list.

The British Hospitality Association estimates that 2% of those working in the industry have lost their jobs in the past six weeks. Now that restaurants are a far more significant part of the service industry than ever before, the repercussions from any slowdown will be more widespread. London's taxi drivers and wine merchants are already affected. And the growing number of British farmers who have focused on quality to differentiate themselves are worried: they rely on restaurants as prime customers and as showcases for their produce.

Some people think that a shake-out would be beneficial, because it would rid the business of second-rate establishments. The trouble is that too much of the capital's restaurant industry is vulnerable. Over the past eight years, during which many indigenous chefs have come to the fore and London has acquired a culinary reputation to rival that of Paris and New York, the industry has failed to address its structural weaknesses. It remains highly fragmented, under-capitalised, labour intensive and predominantly low-skilled: not the ideal position to be in as the business heads south.

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Bagehot

Well blow me down

Dec 13th 2001
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Robin Cook is reforming the Commons. Up to a point

ON FIRST being admitted to the “Lobby”, the cabal of journalists licensed to roam the Palace of Westminster and report, subject to certain rules, what they see and hear, your columnist—in a state then of prelapsarian innocence—telephoned the Lobby's most senior member to ask what these rules were. “If you have to ask,” barked this eminence, before slamming down the phone, “you can't be a proper member of the Lobby.” As with the journalists who write about it, so with the members who are elected to it. The first rule of the British Parliament is to keep newcomers in the dark, so that veterans who think they understand its esoteric procedures can turn this information into power.

After two Labour landslides, the proportion of confused newcomers in the House of Commons is high. More than half of the ruling party's MPs were elected last June or in 1997. So it is excellent that Robin Cook, who is both leader of the House and a veteran of three Commons decades, unveiled reforms this week that should make its proceedings more comprehensible. Indeed, he claims to be doing more than this. Deploring the low turnout in June's election, in which six out of ten younger voters stayed home, Mr Cook is calling on Parliament to recognise how antique it looks to any elector under 35. He aspires to change its culture as well as its rules. Whereas Britain conducts most of its business with brevity and informality, he says, Parliament's conduct is perplexing, ritualised and longwinded. Whereas voting has become less tribal, the Commons is still dominated by the polarised “mud-wrestling” of the political parties, which “turns voters off in droves”. Without change, it will become ever more marginal: already “every cabinet minister knows...that a statement in Parliament now attracts less media attention than almost any other way of making the announcement.”

Mr Cook's ambitions make a splendid contrast with the perfunctory approach of Margaret Beckett, who before being reshuffled in June to look after farming and food made minimal changes in the House of which she was then leader. Some MPs had worried that being dumped without warning from his old job as foreign secretary might send Mr Cook sulking and supine into his new and less exalted one. To judge by this week's comments, he has decided instead to make something of it. Breathing new independence into the Commons would, after all, be a fitting sequel to the broader constitutional changes, such as kicking the hereditary peers out of the Lords and devolving power to Scotland and Wales, which he negotiated five years ago as part of a Labour agreement with the Liberal Democrats. It might also provide a subtle revenge against Tony Blair, the Parliament-allergic prime minister who demoted him. So far, so good for the cause of Commons reform.

Or so you might think. For Bagehot has been dreading the moment of bathos when he can no longer avoid disclosing the detail of the mooted reforms. They are not minor. They are not meaningless. But nor do they seem adequate to the culture-changing task Mr Cook has set himself.

Mr Cook would like the Commons to make better use of its time, by holding more debates, but fewer that last all day. He suggests that MPs might put more topical questions to ministers if they did not have to give two weeks' notice. He thinks that the Commons should start work more often in the mornings, not least to give the media more time to take note of and report what MPs are talking about. For the same reason prime minister's questions, the ritualised anti-climax of the British political week, might take place before instead of after Wednesday lunch. He would like to alter the parliamentary year by doing away with the long summer recess, and to enable uncompleted bills to be carried over from one parliamentary session to another. This way, the tidal wave of legislation introduced in spring to meet a November deadline might be replaced by an orderly pipeline, with more time for MPs to study the detail of the bills. And he would like more of that legislation to be published in draft form, so that MPs on the specialist select committees have an earlier chance to influence its final shape.

By the slow-evolving standards of Westminster, these are big changes. Taken together, they might make a real difference to the efficiency with which Parliament performs what Mr Cook considers its proper job. And this, he insists, is not to oppose, obstruct or counter-balance the power of the government but to scrutinise the things the government does.

Here Mr Cook is right. No student of Britain's constitution would challenge his idea that the job of the Commons is to hold the government to account. The trouble is that the non-voting young he claims to be so worried about are not students of the constitution. Nor, as it happens, are the members of the Lobby, which long ago stopped taking an interest in every Commons debate. This is not because Commons procedures are arcane or its debates dull. Even excellent debates about burning issues—race and Britishness, the war in Afghanistan, terrorism and civil rights—can go largely unreported. The lack of interest stems from a growing understanding by voters, non-voters and the media that under Britain's system the executive can almost always get its way and that Parliament has very little power.

Will Mr Cook be able to give the Commons more of it? At most, he might line up with the backbenchers calling for the greater independence of the select committees. They would like to reduce the role of party whips in nominating the committees' members, give them more staff and maybe call them “scrutiny” committees to emphasise their inquisitorial role. But this is a government that has shied away from any reform—an all-elected Lords, proportional voting for the Commons, a big cut in the excessive number of MPs or patronage-hungry ministers—that threatens to disturb the existing domination of the legislature by the executive. Not even Mr Cook looks likely to change that.

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European merger rules

Monti braves the catcalls

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The European Commission's effort to update its controversial rules governing mergers may bring some improvements. But it is not going far enough

AS EUROPE'S competition supremo, Mario Monti has become used to being a target for criticism, some of it bitter and personal. After all, he and his Merger Task Force can block mergers between companies, and they have not been shy of exercising their powers. But even the battle-hardened and politically astute Mr Monti must have been shocked by the barracking that greeted his publication on December 11th of an important discussion document that should lead to a revised set of merger rules for Europe. What is going on?

Mr Monti, it seems, is guilty of only half listening to his critics. He was correct to think the market would welcome an overhaul of the merger regulations. But, say the critics, he underestimated the pent-up frustration felt by international companies, and the lawyers and bankers who advise them on mergers and acquisitions. They have long argued that the structure used by the European Commission to decide on mergers is fundamentally flawed, and that a fairer regime is needed. As soon as they realised that the new proposals would fall short of a fundamental overhaul, the chorus of boos began.

Mr Monti is well aware that this year has been the most controversial ever for his task-force. It has included the blocking of a proposed merger between two giant American companies, General Electric and Honeywell, and the busting-apart of a completed merger between Schneider and Legrand, two French electrical companies. The Americans, in particular, were furious to find that their deal, already approved at home, could be thwarted in Europe. But Mr Monti stood up to political pressure, and GE and Honeywell parted ways. At the time, Americans were heard muttering that he was the most dangerous man in the world (though he may now have been pipped by Osama bin Laden).

The critics of Mr Monti who vented their spleen again this week presumably had not paused to read the lengthy and (for the most part) well-argued discussion paper. On close inspection, it is a balanced contribution to the debate on merger control. It makes specific recommendations, such as changes to the cumbersome rules that set thresholds for investigations, and requests contributions on how best to shape future policy.

The document deals with issues that go to the heart of most recent controversies. For instance, Mr Monti is willing to hear opinions on whether the much-pilloried European test of market dominance is better than the American test that a merger must not greatly reduce competition. The document says that convergence on this issue could be a good thing—a huge nod towards America and the ill-feeling that resulted from the GE-Honeywell decision. Mr Monti is also floating the idea of allowing companies more time to argue their case during in-depth investigations.

Moreover, he has opened a debate on crucial procedural matters, such as Europe's inadequate system of

judicial review once a merger has been blocked. At present, companies that want to appeal against a decision must wait months before their case can be heard in the European Court. By the time a case reaches the court, markets have usually moved on to a point where the original deal is no longer feasible. Companies do challenge commission decisions (GE is doing so, for instance); but more with legal principles in mind than with a view to saving their merger. Changes that speed up the appeals system will now be aired.

Judge and jury

So why all the fuss? The problem is that Mr Monti's proposals and questions are framed so that the crucial issue of how the Merger Task Force operates during an investigation will not be addressed. Critics argue that the real problem is that the commission has too much unchecked power. Case officers, they say, both investigate and decide on specific mergers, and there is no independent test of their decisions; some officers seem to make up their minds before studying the facts. Outsiders see this lack of checks and balances as a fatal defect in the system. Mr Monti, they say, has arrogantly chosen to ignore this view.

In fact, he thinks that the controls in place are more than adequate. This week's document points out that the commission's legal services carefully test blocking decisions to make sure they can withstand appeal. It also says that the current procedures involve constant testing by internal committees. These observations are used to justify the decision not to call for a debate on procedure from first principles. Rather, suggestions must be “in the spirit” of current working methods.

This attitude stems from an overly legalistic approach to reform and, yes, a little arrogance. The commission says its brief is to review merger rules as a matter of law, but not its internal procedures, because they are not enshrined in law. This, mutter some, is reminiscent of Bill Clinton's tortured definitions of what constitutes sex. An otherwise impressive document thus lacks the one element that might have silenced Mr Monti's harshest critics.

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Competition policy in Mexico

Distrust in antitrust?

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Is the government promoting competition or confusion?

NOBODY knows quite what to make of it. In September Mexico's president, Vicente Fox, who took office a year ago, made his first evident decision about competition policy. He named a new member of the Federal Competition Commission (CFC, by its Spanish initials), the country's antitrust agency, after another commissioner's term expired. The new man, Agustin Navarro, is certainly able: he is a businessman, lawyer and professor of economics at one of the country's top universities. But he is a libertarian and also a fierce critic of antitrust policy—the competition agency's very reason for existing. Does Mr Fox think the same way?

If so, it would be a radical shift. The previous government was divided between protectionists who favoured strong national companies, and liberals who wanted monopolies broken. The CFC, created in 1994, has jealously cultivated a reputation as one of the few truly independent government agencies. Though it technically belongs to the economy ministry, it handles its own budget, and its five commissioners meet alone, behind closed doors. It has forged an aggressive antitrust policy against Mexico's traditional monopolies and oligopolies, though some accuse it of having different standards for different industries.

As a result, it has often made enemies—above all in telecoms. While the CFC chipped away at the power of Telmex, the former state monopoly, a protectionist communications minister cosseted the company. With a weak telecoms watchdog, a generous concession title (written before the competition commission was born), a team of well-paid lawyers and its sheer muscle as Mexico's biggest private-sector company, Telmex often made mincemeat of attempts to keep it in line. When the CFC ruled in 1998 that the company was dominant in five big markets, it took Cofetel, the telecoms watchdog, over two years to draw up the appropriate new regulation, which Telmex has since been holding at bay with lawsuits.

Now things look to be changing. The new communications minister, Pedro Cerisola, holds more free-market views than his predecessor. Last month he at last replaced the head of Cofetel. And next year the government hopes to pass a new telecoms law. This would strengthen Cofetel, make it easier for small telecoms companies to break into the market and give all companies incentives to provide service in unprofitable rural areas.

Yet the new law has been in the making for years, and there are precious few other hints about Mr Fox's thinking on competition, beyond the naming of Mr Navarro. Is he there to nudge competition policy towards a more liberal, hands-off approach? (Mr Navarro says he is “for a more modern policy in line with the process of globalisation”.) Is he to be the agency's next head after Fernando Sanchez Ugarte, whose ten-year term ends in 2004? Or was the economy ministry, where he served a brief and unsuccessful stint as head of the anti-dumping unit (during which Mexico lost a dispute with the United States), just looking for a place to dump him?

Some in the CFC, especially those worried about losing their famed autonomy, have a darker view: that Mr Navarro is the economy ministry's mole, reporting back on the agency's secretive decisions. Whatever the truth, the appointment has created more confusion than clarity.

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Microsoft

United they would stand

Dec 13th 2001 | SAN FRANCISCO
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Microsoft's legal woes are far from over. Does it have much to fear?

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AP

Hey, that's not our software

IT COMES as a surprise, given Microsoft's notorious tenacity, but the software giant is definitely out to clear its antitrust plate. After its settlement with the Justice Department, the company has now struck an agreement to end more than 100 private class-action suits and signalled that it wants to do the same for the case brought against it by the European Commission. As if to underline this new approach, Microsoft recently announced that William Neukom, its long-serving general counsel, will soon be replaced by Brad Smith, his more convivial deputy.

Yet recent events suggest that it will not be that easy for Microsoft to shrug off its legal woes. For a start, the nine state attorneys-general opposing the federal settlement have asked the trial judge to impose tougher remedies. Another judge supervising the class-action suits has questioned Microsoft's plan to settle all of the cases by donating $1 billion to poor schools. And this week, a Senate committee hearing was dominated by criticism of the federal settlement.

The least of Microsoft's problems are the class-action suits, filed on behalf of consumers who say they were harmed by the company's behaviour. Giving money to schools is a good idea. But half of the gift would be in the form of free Microsoft software, costing the company almost nothing, and hurting competitors in the education market, mainly Apple. So worried is Steve Jobs, Apple's boss, that he has publicly criticised the deal—after having kept quiet during the entire antitrust trial. The judge's remarks suggest that Microsoft will have to pay cash in full if it wants him to approve the agreement.

The proposal of the dissenting states is more serious. Their suggested remedies do more than just plug the loopholes in the main settlement and provide for tougher enforcement. They would take back much of what Microsoft has won by abusing its monopoly power. Central to the plan are remedies concerning Microsoft's browser software and the Java programming language: the company would be forced to license the source code to its browser, and to make sure that Java programs can run on Windows. Microsoft would also be required to offer a stripped-down version of Windows so that PC makers could choose add-ons other than its own.

Parallel tracks

Microsoft says that the proposed remedies are “extreme and not commensurate with what is left of the case”. Colleen Kollar-Kotelly, the trial judge, will decide next spring. She has put the case on two parallel tracks. One is a review of the existing Justice Department settlement (under the Tunney act) to determine if it is in the public interest. The other is litigation over the newly proposed remedies.

The European Commission, for its part, will probably wait and see what transpires in America before proceeding. It is unlikely simply to rubber-stamp the outcome, as Microsoft has suggested. For one thing, European regulators have disagreements of their own with the company, chiefly that it is trying to extend its monopoly into the server and media-player markets.

But competitors and critics of the software giant, who have heavily lobbied both the states and Brussels,

should not get their hopes up. Given the economic and political environment, it is still unlikely that Microsoft will get more than a slap on the wrist, even if it hurts more than the company would like. Its rivals would perhaps do better to concentrate their energies on forming alliances that could help to keep Microsoft in check.

To some extent this is already happening. The “Liberty Alliance”, for example, is gaining momentum. American Express and AOL Time Warner recently joined this coalition, whose goal is to provide an alternative to Microsoft's online authentication service, called Passport. Similarly, if the entertainment industry got its act together, it might be able to stop Microsoft defining the standard for digital copy-protection. Perhaps this time around, such alliances will prove a better match for Microsoft's determination.

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Fiat falters

Nibbling the bullet

Dec 13th 2001
From The Economist print edition

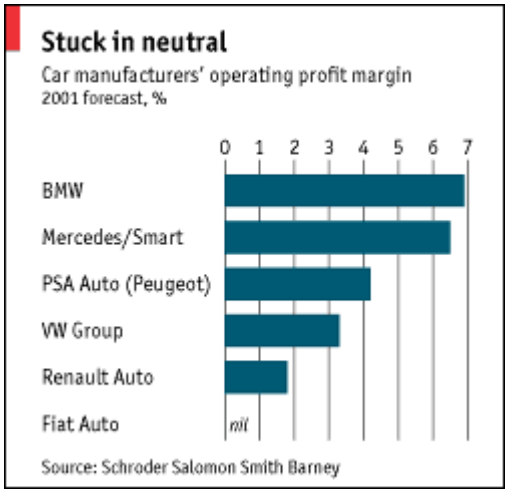
Fiat Auto loses its boss and restructures its factories and finances

FIAT'S top managers convene in Turin this weekend for their annual review. They have plenty to consider. On December 10th the boss of Fiat Auto, Roberto Testore, resigned, paying the price for his failure to sort out the problems of the Italian group's car-making business, which staggers from loss to loss even as the European car market booms. On the same day, Fiat also announced a rights issue, to raise *euro*1 billion ($900m), and a $2.2 billion bond issue, as it attempts to cut its debt of *euro*7.5 billion to *euro*3 billion. Paolo Cantarella, the company's chief executive, wants to raise *euro*2 billion from disposals, such as the Magnetti Marelli car-parts business—even though an attempt to do this earlier this year failed. A restructuring charge of around *euro*800m will push the group into a net loss for 2001.

Fiat Auto has limped along for years, suffering from an over-ambitious global plan and ageing products. It expanded in Latin America with its Palio car project, only to be hit by economic woes in Brazil and Argentina. It was big in Central Europe, but was undercut there by Daewoo. In its core west European market, it missed out on the boom in mid-sized cars and minivans, because its offerings were either boring or eccentric (like the ugly Multipla).

Fiat's profit margins are thin or non-existent, because it cannot command high prices for its small cars (see chart). It has been slow to adjust to shortening product cycles in Europe's competitive car market. Its labour productivity scores high in cars per man-year, but the company has too many factories. Capacity utilisation is less than 75%, below the 80% level at which most volume car companies start to make money. Fiat said this week that 15 manufacturing sites will be shut or shrunk by 2004, with a loss of 6,000 jobs. It hopes the latest cuts will raise utilisation to 90%.

Two years ago, as global consolidation caught on, Fiat and PSA Peugeot Citroën of France looked the most vulnerable European volume car makers. Last year Fiat tied a sort of knot with General Motors, with GM taking a 20% stake in Fiat, which got 6% of GM in return. But the benefits from such things as shared purchasing are still a modest *euro*230m a year; not until 2004 will much bigger gains emerge.



Peugeot, meanwhile, has gone from strength to strength. Its sales and profits have grown thanks to good models, not just in small cars but in the more profitable mid-sized segment. It now makes 3m units a year, compared with Fiat's 2.2m, a reversal of their positions five years ago. Unlike Fiat, Peugeot eschewed ambitious global plans, happy to do over 80% of its business in Europe, where it ranks number two behind Volkswagen by sales and has the highest profit margins of any volume car producer (trailing only the upmarket Mercedes-Benz and BMW). So confident is its chief executive, Jean-Martin Folz, that he said this week he was looking to expand in Latin America and China. Perhaps he should look at Fiat, and think again.

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Conrad Black's newspapers

Not so black and white

Dec 13th 2001
From The Economist print edition

The Canadian-born press baron is reshaping his empire

HE HAS been selling newspaper titles in Canada, backing a new one in New York and trying to quash rumours that he is selling them in Britain. What exactly is Conrad Black, chairman of Hollinger, ex-Canadian, newly ennobled Briton, up to?

Last month, Lord Black of Crossharbour, as he is now known, sold his remaining local newspapers in Canada. This came shortly after he had offloaded his residual 50% stake in the *National Post*, the Canadian daily paper he founded only in 1998, to CanWest Global Communications. This Canadian media group had already picked up the other half last year, along with most of Lord Black's other local newspapers in the country, for $1.8 billion.

Shorn of its Canadian operations, and apart from the tiny *Jerusalem Post*, Hollinger has now been pared down to two chief assets: the *Chicago Sun-Times*, plus a bagful of local papers in that area, and the *Daily Telegraph*, Britain's most popular broadsheet paper. After the group recently reported a net loss of $9m for the nine months to September, excluding exceptional items, rumours swirled that even the *Telegraph* might be for sale.

Not so, says Hollinger. Although earnings at the *Telegraph* and its Sunday sister are well down on last year, and the papers plan to sack up to 40 editorial staff, they still provide most of the group's profits. “There is no substance at all to the story that the *Telegraph* is for sale,” says Daniel Colson, Hollinger's vice-chairman. Indeed, having stemmed the *National Post*'s losses and booked a good price for the sale of most of its Canadian assets last year, the group has cut its heavy debt burden and is well-placed to look for new projects.

But what? Economies of scale in the newspaper market are best achieved with the local and regional press. The ideal business model, says Peter Kreisky of Mercer Management Consulting, is a geographical cluster of regional titles. With local monopoly power, this can bring down the cost of paper and ink, of printing and distribution, and of marketing. Hollinger enjoys many of these benefits in the Chicago area, where it has 97 papers.

But it is far harder to achieve cost-sharing across international borders. Most national papers are still run from and owned in their home country. Those that belong to an international owner, such as Hollinger, Tony O'Reilly's Independent News and Media and Rupert Murdoch's NewsCorp, concentrate on English-speaking markets. Are there synergies across these? “Not many,” Mr Colson concedes.

Yet owning newspapers is as much to do with kudos and influence as it is about profits. Although he would not rule out opportunities even in non-English-speaking parts of Europe, Lord Black's sights now seem to be set on the United States. He has just made a small bet on a new quality paper, the *New York Sun*, by putting in $2m, or about 13% of the total investment. Although Hollinger stresses that it is only loosely involved, the project is nevertheless intriguing. There has long been a view that New York, a city of 8m people, ought to be able to support more than one all-round quality newspaper; yet the *New York Times*, with a circulation of 1.1m, has no direct cross-town rival.

Lord Black's experience of launching a new title, the *National Post*, in Canada may be salutary. He managed to create a franchise from nothing in a competitive market, and in doing so stirred up political controversy in consensus-minded Canada. But it never made him any money, which may be why his bet on the *New York Sun* is so modest. Buying established but faltering papers would make more sense. “There will be investment opportunities arising from this economic downturn that Hollinger's increased financial strength will enable us to take advantage of,” says Mr Colson, “not only in New York, but

elsewhere in the US.”

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Russian customs

Border bore

Dec 13th 2001 | MOSCOW
From The Economist print edition

Bend the rules or be broken by them

AP

Baby food, you say?

SHORTAGES were so endemic in the Soviet era that they barely merited a mention. Nowadays, even the brief absence of a favourite brand makes Russians cross. The culprits are no longer planners, but customs officials, engaged in a periodic attempt to enforce their vague and voluminous rule-book. The results have been huge delays on Russia's borders. Lorries have been waiting up to five days, rather than a few hours. As a result, coffee has been hard to find in Moscow. At the airport, foreign magazines are spending a week in customs.

Russian babies consume remarkable amounts of coffee, alcohol and tobacco

Russia's 58,000 customs officials mostly earn only $50-100 a month, and (crackdowns aside) have plenty of discretion about which rule to enforce and how. As a result, corruption is rampant. It used to be wads of cash. Now it comes disguised as fees to well-connected customs brokers. On paying such fees, crooked importers can, say, have goods undercounted or reclassified into a lower-tariff category. Baby food, for example, may be imported duty-free; so Russian babies consume remarkable amounts of coffee, alcohol and tobacco. This penalises honest importers—it is hard to make money when your competitors' goods are almost duty-free.

There are signs of change. Tariffs have become simpler, although the classification system is still “monstrous”, according to Art Franczek, who lobbies on behalf of the American Chamber of Commerce. Top officials are more willing to discuss technical issues, such as the treatment of leased equipment.

Even supposedly better-governed post-communist countries have problems with customs services. In Latvia, a newly installed video monitoring system at the main crossing-point with Russia has been plagued by disabling lightning strikes. Oddly, but conveniently for crooked officials, these cause no other damage, and the storms do not feature in local weather reports.

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Germany's Mittelstand

Slipped disc

Dec 13th 2001 | DORTMUND
From The Economist print edition

The family firms that form the backbone of the German economy have more to worry about than recession

THE sad story of SchmidtBank is a timely parable for the *Mittelstand*, the 3m or so mostly small, owner-run firms that constitute the mass of German business. Itself a family firm, founded in 1828, SchmidtBank specialised in lending to small firms in Bavaria and neighbouring states. Last month, facing extinction, it was rescued by a group of big banks, which paid *euro*1 (89 cents) between them for the Schmidt family's 65% stake. The bank lacked the wherewithal—*euro*400m, it is said—to make provisions against its bad loans. Its troubles partly reflect the parlous state of Germany's economy: GDP is shrinking and bankruptcies are rising.

However, the case captures one of the two longer-running problems facing *Mittelstand* companies. Bank credit, their main source of finance, is getting harder to come by. They blame international banking guidelines, known as Basel 2, which are currently under negotiation, and Germany's big banks, which they believe have lost interest in small business.

SchmidtBank's owner, Karl Gerhard Schmidt, was known as a patient lender. His failure now looks like a strong argument for Basel 2. Under the existing Basel guidelines, banks are supposed to have capital of at least 8% of their risk-weighted assets. The idea now is to tune capital requirements more finely to risks. In theory, this should mean higher borrowing costs, or a refusal of credit, for riskier borrowers.

The thought is putting the wind up the *Mittelstand*. At present, says Stefan Schmittmann of HVB, Germany's second-biggest bank, the interest rate on a typical *Mittelstand* bank loan is lower than that on bonds issued by DaimlerChrysler: reform should bring loan margins closer to those in the capital markets.

German negotiators have won some helpful changes to Basel 2, for example a broadening of the range of eligible loan collateral. Still, some contentious points remain, such as the risk-weighting of long-term loans, on which the *Mittelstand* are especially dependent. The German chancellor, Gerhard Schröder, has said that only a more *Mittelstand*-friendly accord will win Germany's approval.

Experts from the big banks retort that companies with good credit records, which are well managed, or which have built up their own equity, should see interest rates fall, because they will give their bankers fewer sleepless nights. Some firms, comments one banker, tell their banks little more about their profitability than they tell inquisitive journalists.

The big banks, sniffs small business, are in any case no friends of the *Mittelstand*. The banks, trying to boost their pitiful returns from commercial banking, are closing branches by the hundred. Their share of lending to *Handwerk* (craft) companies, ranging from hairdressers to builders, has fallen by perhaps half in the past ten years.

The big banks insist that they are still keen to serve the *Mittelstand*. By this, however, they mean only the bigger companies. At the top end, banks can sell more sophisticated products than boring old low-margin loans. Moreover, they say, they were never the mainstay of small-company lending. Ten years ago, Germany's three biggest banks accounted for only 4.3% of *Handwerk* loans. Around three-fifths came from the hundreds of public-sector savings banks, as they still do.

Under the most pressure to look for new sources of finance, smaller firms are least well-equipped to do it. Small corporate-bond issues are not really worthwhile, yet few firms are big enough to consider a stockmarket flotation. Private equity is an option for some, if they are prepared to accept it: owner-

bosses are used to being masters in their own houses.

Dropping the baton

The second long-term difficulty for the *Mittelstand* concerns the handover of firms from one generation to the next. The norm is still for relatives to take over: the destiny of more than 40% of firms, estimates the Institute for Mittelstand Research (IfM) in Bonn. But this apparently simple trick can be hard to pull off.

At Steilmann Group, a clothing manufacturer with sales of DM1.2 billion ($550m), the process has gone full circle. In 1999 Britta Steilmann, eldest daughter and obvious successor of Klaus Steilmann, quit the firm after a dispute over strategy. Later that year an outsider, Joachim Vogt, who had been chief executive of Hugo Boss, was brought in to take the reins from Mr Steilmann. This summer, after two difficult years, Mr Vogt departed—to be replaced by the returning Ms Steilmann.

Plenty of smaller firms have also had troublesome successions. “There are too many examples where the owner...starts looking for a successor much too late,” says Hanns-Eberhard Schleyer of the national *Handwerk* federation. A growing number of bosses are finding that their children do not want to run the firm.

Not enough small companies have planned for the inevitable day when the boss is no longer there

A want of ready successors, reluctance to relinquish control and plain lack of foresight have meant that not enough small companies have made plans for the inevitable day when the boss is no longer there. So business groups and the economics ministry are encouraging owners to prepare, by the age of 55 at the latest. According to the IfM, about 80,000 German companies change owners every year. Old age is the cause only 40% of the time. More than 30% of firms lose their bosses to an accident, illness or premature death. If an unprepared relative or employee has to take over in a hurry, says the IfM's Gunter Kayser, the firm can be vulnerable: with money at stake, competitors, suppliers and the bank might be ruthless rather than sympathetic. Under Basel 2, he adds, banks will take a firm's succession plans into account when assessing lending risk.

The *Handwerk* federation, the economics ministry and the Deutsche Ausgleichsbank, a state-owned financier of young companies, are trying to make the search for a successor easier. At www.change-online.de, a “company bourse”, there are all sorts on offer, from a carpentry business near Munich to an optician's in Wuppertal. All the advertisements are anonymous, usually posted by the local chamber of commerce or savings bank, so that customers and competitors are not tipped off that the owner is ready to call it a day. The bourse, set up in 1999, has been used in the handover of more than 1,500 firms.

For would-be entrepreneurs, buying an established family firm is an alternative to starting from scratch. Hearing Ulrich Assmann describe Capito & Assenmacher, an engineering firm he owns and runs on the outskirts of Dortmund, you might imagine he had been there all his life. In fact, Mr Assmann came to Dortmund only last year, having bought the firm from Bärbel Assenmacher, daughter of one of the two ex-army officers who had founded it in 1946. After a long career running family businesses, from a silversmith to an industrial-clothing firm, for other people, he wanted his own company. He spotted an advertisement (anonymous, naturally) for Capito & Assenmacher, and liked what he saw. Ms Assenmacher introduced him to staff and clients, worked alongside him for three months, and then handed over; she now sits on the advisory board. No customers or employees were lost, he says, and turnover should be up by about 18%, to DM16.5m, this year.

On the other hand, the smoothest-looking successions can be upset. At SchmidtBank, Mr Schmidt had been at the helm for almost 40 years. It seemed a safe bet that his son Karl Matthäus, who runs Consors, the bank's online-broking subsidiary, would one day succeed him. Now SchmidtBank is in strange hands and Consors is for sale. After five generations, a fixture of the *Mittelstand* is no more.

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About sponsorship

Face value

In the family's way

Dec 13th 2001
From The Economist print edition

Why Carly Fiorina failed to sell her vision to the Hewletts and Packards

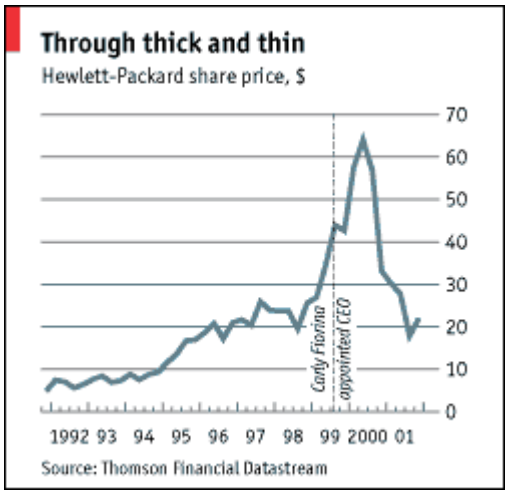
Get article background

"SHE'S a fighter," say her friends and foes alike. Certainly Carly Fiorina, chief executive of Hewlett-Packard (HP), needs all her considerable spunk at the moment. The deal on which she has staked her career, a $24 billion merger with Compaq Computer, is teetering on the edge of collapse now that the David and Lucile Packard Foundation has said it will vote against it. With two other family foundations already hostile, that lines up 18% of the shares against the deal. This week Michael Capellas, chief executive of Compaq, hinted that his company might yet have a "standalone" future.

Even before the Compaq deal, Ms Fiorina had a big fight on her hands. She arrived at HP in 1999 with several qualities that set her apart from that venerable company's previous top brass. She is young (only 47), glamorous and a woman, one of only half a dozen at the helm of a Fortune 500 company. She is not an engineer: her Stanford degree is in medieval history, and her skill is as a superb saleswoman. She was also an outsider, coming from a sparkling career at Lucent Technologies, a company that was still riding high when she left.

Ms Fiorina took over a company that saw its tolerant, people-oriented culture as one of its proudest achievements. But HP had lost pace and direction. It had been slow to notice the Internet; its PC business had not espoused Dell Computer's winning model of direct sales; its share of the market for big servers was slipping. In hiring her, recalled Jay Keyworth, an HP board member, earlier this year, the directors asked her "to totally recreate and reinvent HP according to the original HP way". She warned them that such a change would take at least three years. "Are you going to stick with me?" she asked. "We absolutely said yes," said Mr Keyworth.

Three years are not up, but Ms Fiorina has found it harder to fulfil her brief than she expected. She tried to claim descent from the company's famous founders: early on, she posed in a commercial in front of the garage in which David Packard and Bill Hewlett started the company 63 years ago. But she has had bad luck, compounded by bad judgment that may reflect either inexperience or her marketing past. Having notched up a sparkling first year, she promised a second that was even better. That unwise pledge, made a year ago, cost her credibility and support in the markets. She also failed to lead the company in a new direction when her attempt to buy the consulting arm of PricewaterhouseCoopers collapsed. That would have extended HP's reach into IT services.



Above all, she seems to have found it hard to alter HP's entrenched culture. She embarked on a high-speed programme of restructuring, to reduce bureaucracy. That stirred up irritation in a company whose managers were used to being left to run their baronies in peace. The economic downturn, and the consequent need for lay-offs, left her fighting a barrage of complaints from staff that she was brutally putting markets before people.

The merger with Compaq offered a way to solve several of these problems at once. It would ram through the cultural change that had proved so elusive. It would boost IT services. And it might restore HP's fortunes in the market for PCs, where the combined company would have 19% of the world market, and for servers, where it would have 37%.

If not, then what?

Had the Compaq deal come a year earlier, and been steered by a more experienced leader, it might possibly have gone through. But Ms Fiorina seems to have underestimated the scepticism of the markets, which still remembered the hash Compaq made of its acquisition of Digital Equipment in 1998. She also misjudged the reaction of the founders' children, led by David Packard and Walter Hewlett.

Mr Packard, an emotional philanthropist, was aghast at the scale of the lay-offs that the merger would entail—at least 15,000jobs, bringing the loss during Ms Fiorina's reign to one in six HP staff. When he publicly attacked the merger, he was deluged with admiring letters from HP staff, attacking Ms Fiorina's high-handed management.

Mr Hewlett's opposition is founded less on emotion than on disagreement with the deal's rationale. Ms Fiorina, with her background in telecoms, exaggerates the importance of scale in the computer business. As a result, HP will hand over to Compaq shareholders one-third of the equity in its high-margin, market-dominant printing and imaging business, and get in exchange a stake in Compaq's low-margin PC business. Scale in the PC business is less important than nimble execution, which means selling machines directly, something Compaq is only just starting to do. And merging the two server businesses will annoy many customers, who have existing investments in one of two technically incompatible product ranges.

An outside manager running a family firm always has a hard task. In a disagreement, the hired help usually goes, as Jacques Nasser did in October after losing the trust of Bill Ford. When the family firm is a quoted company, the tensions increase: family shareholders, with their large holdings of a single stock, dislike risk more than most other investors. This, argues the Fiorina camp, explains the approach of the Hewletts and Packards, whose HP stock finances generous donations to various good causes. They have a powerful incentive to “preserve wealth rather than to create it”.

Even if the merger collapses, HP will need to change. For the moment, though, Ms Fiorina is battling on. The real fight, she is bravely insisting, still lies ahead: the date for the shareholder vote will not be before February, and institutional investors have a tendency, in arguments with family shareholders, to support the management. But her wounds look mortal. It is surely only a matter of time.

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European clearing and settlement

Werner's silo

Dec 13th 2001
From The Economist print edition

Deutsche Börse expands its high-rise empire

WERNER SEIFERT, chief executive of Deutsche Börse, may look like a pipe-smoking teddy-bear. But to advocates of a pan-European market for trading, clearing and settling securities he is fast becoming public enemy number one. Especially since December 7th, when Deutsche Börse won exclusive rights to negotiate a merger with Clearstream, one of the two main depositories for international securities in Europe. It beat off a rival bid from the other, Euroclear, by exercising its veto as owner, already, of 50% of Clearstream.

If the merger goes through, say Mr Seifert's critics, it will establish a vertical, German-owned “silo” at the heart of Europe's securities market, making it much harder to reduce the costs of cross-border trading in Europe. These critics, led by the European Securities Forum—an informal group of banks—want horizontal, not vertical integration: stock exchanges merging or co-operating with other exchanges, while separately owned depositories and clearing-houses integrate with each other. They argue that this will be cheaper, offer freer access to all and ensure greater price transparency.

On December 12th the London Stock Exchange and others announced a step towards such horizontal integration, which will allow Euroclear as well as a London-based depository, Crestco, to settle stock exchange trades cleared by the London Clearing House. (Once a securities trade is agreed between exchange members, a clearing house ensures that both sides of the transaction are honoured; a depository holds the securities and settles trades by moving them from one account to another.)

The path to a single European market for securities is beset with barriers created by differences of law, tax, technology and local market practice. A recent report for the European Commission on cross-border clearing and settlement, by the Giovannini group, concludes that these barriers add enormously to transaction costs for investors. Cross-border settlement, even via international depositories such as Clearstream and Euroclear, costs around ten times more than domestic settlement, according to some estimates. Such inefficiency, the report says, “is inconsistent with the objective of creating a truly integrated EU financial system.”

Deutsche Börse retorts that cross-ownership of exchanges, clearing houses and securities depositories (ie, vertical integration) is not seen by the report as a barrier. The exchange shrugs off, and even seems to relish, general hostility to the silo model. “I'm a businessman,” said Mr Seifert in London recently. “I act in the interests of my shareholders.”

The hostility is freely expressed both in the marketplace and by the European Securities Forum. One derivatives practitioner resents the “concentration of power” in Deutsche Börse and its apparent “failure to understand the concept of user governance”. Yet when Deutsche Börse put cash on the table, such objections seemed to fly out of the window. Fourteen members of Clearstream's 18-strong board, which unanimously agreed to Deutsche Börse's advances, are representatives of big banks and investment banks that are also part of the very same Forum that is opposed to silos. In the end the banks had little choice, under the threat of Deutsche Börse's veto, concedes Pen Kent, executive chairman of the Forum.

Clearing and present danger

The debate on vertical versus horizontal integration is somewhat ideological. Vertical silos may offer less choice and less transparent pricing, because trading, clearing and settlement are bundled together. Horizontal integration in theory allows users to choose the most efficient service at every stage. A central clearing-house would reduce risk by allowing netting of many positions. And such entities are more likely to be efficient, say ideologues, if each service is owned by users, not by profit-maximising shareholders.

Deutsche Börse is a listed company, meaning that it has incentives beyond providing the lowest-cost service to its users. Considering its near-monopoly position in the German market there needs to be a check on this. Deutsche Börse insists that job is done perfectly well by its governing council, representing users. Others are not so sure. One of them is the European Commission, which has sent Deutsche Börse, among others, two questionnaires this year, exploring competition issues in the securities markets.

The European Central Bank has shown a preference for horizontal integration, judging it to be less accident-prone than silos. The Group of Thirty—a think-tank of leading financiers—in a report on clearing and settlement, due next year, is expected to favour the American model of a single not-for-profit clearing and settlement counterparty, the Depository Trust & Clearing Corporation. The DTCC was not a market-driven solution, but a product of regulators who encouraged a merger of regional securities depositories.

The DTCC this month established a European central counterparty (EuroCCP) for Nasdaq Europe. When it is up and running, supposedly by year-end, EuroCCP will offer automated clearing and settlement of any trades that are linked to its system. “The other clearing corporations are building what we already have,” crows Jeffrey Smith, chief executive of EuroCCP. However, this new entrant may not prove the killer-application. Nasdaq Europe has negligible trading volume , and EuroCCP has no members yet.

Even so, the advent of EuroCCP may reinforce the development of horizontal, rather than vertical integration. “We could now see two models running in Europe,” says Mr Kent: the vertical silo of Mr Seifert, and the horizontal model of Jean-François Théodore. Mr Théodore is chairman of Euronext, the merged Belgian, Dutch and French stock exchanges. Euronext is completing a merger with Liffe, the London futures exchange. The British products of the Euronext “family” will continue to be cleared by the London Clearing House, while its continental products will use Clearnet. Although Euronext is, like Deutsche Börse, listed, and owns Clearnet, it uses various depositories for settlement. Most Europeans do not expect to see a single central counterparty in Europe, but perhaps two—unless regulators impose one.

Ask European stock exchanges and clearing houses where the biggest threat to their prosperity lies and it is not, they believe, from each other. Mr Théodore notes the growing tendency for big investment banks to act as in-house exchanges for clients. “How do you know whether these deals are done at the best price?” he asks.

Price transparency is the raison d'être of exchanges. A one-stop shop for trading, clearing and settlement may be suboptimal. Deutsche Börse, as a quasi-monopoly, needs—and will surely get—more scrutiny by competition watchdogs.

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New York exchanges

With friends like these

Dec 13th 2001 | NEW YORK
From The Economist print edition

By helping Amex after September 11th, the NYSE has helped itself

AP

That nice Mr Grasso

IN THE aftermath of September 11th, praise rained on Richard Grasso, chief executive of the New York Stock Exchange, for leading the financial markets out of a disaster. But traders from the smaller American Stock Exchange, who, after their building was damaged in the attack, were given refuge by the New York Stock Exchange, have less reason to lionise Mr Grasso, having experienced at close quarters the bitter-sweet charity of the NYSE.

There had long been a tacit agreement among the traditional, floor-based, exchanges to throw a lifeline to one another in the event of a disaster. The American Stock Exchange (Amex), which stood just a few doors from the World Trade Centre, was hit by debris and forced to close down for two weeks. Its flourishing options business was temporarily housed at the Philadelphia Stock Exchange, which has a similar operation. The PhilEx could not have been more accommodating. Hardwired data lines were quickly installed and the traders from New York were allowed to work side-by-side with the natives.

The rest of Amex's operations were transferred two blocks away to the NYSE, including its valuable business in exchange-traded funds. These are funds that replicate such well-known indices as the S&P 500 and the Dow Jones Industrial Average. At first, individual NYSE members offered to share their own workspace with their Amex counterparts, but NYSE officials made an “administrative” decision to cram the Amex traders into two tiny horseshoe-shaped trading pods in a room once used by the exchange. Access to Amex employees was strictly limited, says the NYSE, because of space considerations.

Initially, only Amex “specialists”, who orchestrate trading in securities, were allowed in, and they could receive only electronic orders, which are subject to size limits. Other traders, such as floor brokers and additional market-makers, were forced to stay at home. These play a key role at the Amex by relaying orders from the larger financial firms, adding liquidity and keeping prices keen. Ultimately, after many complaints, a few floor brokers were allowed to return.

This decimation damaged the Amex's most popular product, an exchange-traded fund tied to the Nasdaq-100 index, which includes big companies such as Intel, Oracle and Microsoft. Without the usual order flow at Amex, business shifted to another outlet conveniently, and comfortably, located just a few steps away. Several months ago, the NYSE began trading exchange-traded funds, but with only minimal success. Now, business boomed.

Unfortunately, without the intensely competitive bidding common on the Amex, dealing spreads widened dramatically, providing an extraordinary opportunity for traders at the expense of their customers. One trader reckons that an extra $100m was earned by a small group at the NYSE, with the biggest beneficiary being Goldman Sachs, whose subsidiary, Spear, Leeds & Kellogg, is the relevant NYSE specialist. Goldman's chief executive, Henry Paulson, sits, conveniently enough, on the NYSE's board.

Numerous Amex outfits, on the other hand, were badly hurt. No weekly income statement is produced that shows their losses, but there are indications that some traders on the Amex have been forced out of the business. Since September 11th, the number of Nasdaq-100 market-makers has shrunk from 20 to fewer than 15; and the monthly price for leasing an Amex seat has fallen from $9,000 to $3,500. In recent years there were rarely more than two or three seats at any one time available to lease. Now, 30 are up for grabs. Should the NYSE ever need an emergency safe harbour, Mr Grasso's friends at Amex would surely be eager to return his hospitality.

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British company pensions

Everyone's headache

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From The Economist print edition

Companies wake up to the risks of equity and defined-benefit schemes

THE “pension time-bomb” in Europe is ticking more loudly these days. With investment returns falling and life expectancy rising, every country is engaged in a debate on pensions. Most European countries are hoping that the private sector will assume more of the burden. They look enviously across the Atlantic, notably at companies' individual retirement-savings accounts. Yet even these much-lauded 401 (k) plans, launched 20 years ago, have not always lived up to their promises—a glaring example is Enron (see story on next page).

Britain offers some useful lessons for these debates. Until recently, British policymakers and bosses smugly saw pensions as a continental problem. British spending on state pensions is much lower as a proportion of GDP than in most other rich countries. Britain has already transferred about 40% of the burden of providing pensions to the funded private sector. And its corporate pension funds, heavily invested in equities, had produced good returns thanks to the bull market.

Yet much of this has now changed. The government's stakeholder pension plan, a new scheme launched in April, had a disappointing start. More worryingly, British corporate pension plans have run into trouble over the past year. Many of them are contemplating dwindling assets that no longer cover their liabilities.

One result is that companies have become more active in scrutinising their pension funds' equity performance. Unilever's pension fund trustees have pioneered the most radical form of vigilance. They sued Mercury Asset Management, a fund manager now owned by Merrill Lynch, for negligently managing Unilever's pension fund. The high-profile case was settled out of court last week; Merrill is rumoured to have agreed to cough up £75m ($107m), rather more than half of the damages sought by Unilever.

The Unilever case might inspire similar lawsuits; Sainsbury, another former Mercury client, is looking at it especially closely. But companies are not only reaching for their lawyers. They are also rethinking their entire pension fund policy.

Some are rebalancing their asset allocation, shifting their funds out of equities and into bonds. Over the past 15 months Boots, a drug firm, has switched its entire £2.3 billion pension scheme into long-dated bonds. “A company should minimise financial risk to creditors and shareholders,” argues John Ralfe, Boots' head of corporate finance.

Many other companies have transformed their defined-benefit pension plans, which guarantee employees a pension related to their final salaries, into defined-contribution schemes that make no promises about ultimate benefits. About three-quarters of Britain's corporate pension plans are still defined-benefit plans.

A recent survey by the National Association of Pension Funds found a sharp increase in the number of companies closing their defined-benefit plans to new entrants. Marks and Spencer is just one of 46 companies that axed their defined-benefit plans in the first ten months of this year, compared with only 18 companies in the whole of 2000.

A switch to defined-contribution plans shifts the investment risk of pension funds from employers to employees. Defined-benefit plans, in contrast, are a looming liability that can eat into a company's profits (in case of unanticipated cash calls to top up a pension-fund shortfall). With defined-contribution plans employees instead accumulate a cash pile during their working life to pay for their own pensions.

As defined-contribution plans are more attractive for employers, why did companies not make the switch earlier? One explanation is that companies did not worry when equity markets were rising. Investment

returns were so good in the 1990s that companies could even take holidays from contributing to their pension funds. Another reason is that the red tape surrounding defined-benefit schemes has got much worse. Pension funds also suffered in 1997 from the end of relief from advance corporation tax, a tax on dividends paid to shareholders. The catalyst for the move away from defined-benefit plans was the fall in equity prices, which has hit Britain's pension funds particularly hard. As much as three-quarters of British pension-fund assets are in equities, a much higher proportion than continental and even American pension funds. Over the past two years British pension funds have lost 20% of their value.

Another deterrent to defined-benefit plans is a new accounting standard that will make a company's pension costs crystal-clear. In a couple of years FRS 17, a standard similar to America's FAS 87, will be introduced. FRS 17 will clearly show a company's pension liabilities by valuing pension assets at current market prices and demanding that a pension fund's short-term deficits appear in the company's balance sheet. “There will be no more smoothing of companies' pension costs,” says Alan Rubenstein at Morgan Stanley.

Pushed by weak equity markets and more stringent accounting rules, Britain is likely to follow the American path of 20 years ago. More companies will opt for defined-contribution plans; and a higher proportion of pension funds will be invested in bonds. Today roughly half of American corporate pension plans are defined-contribution schemes, primarily 401(k) plans.

The American corporate pension model is considered a success, even though last year, for the first time, participants in 401(k) plans lost money. A few companies, including General Motors and Ford, have cut or suspended employers' contributions to these plans, citing economic difficulties. “It is a curiosity that defined-benefit plans in Britain lasted for so long,” says John Shuttleworth at PricewaterhouseCoopers, a consultancy. Employees have to agree to the transformation of a defined-benefit into a defined-contribution plan, which many will do only reluctantly. But many more are now having to go along with the idea.

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American company pensions

When labour and capital don't mix

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Enron's demise unmasks conflicts in company pension plans

Get article background

EMPLOYEES who invest in their company's shares solve two problems, in theory. They resolve the issue of agency costs that arises between shareholders and the people hired to work on their behalf. And, more narrowly, they reap the benefits of capital appreciation, a fundamental component of capitalism.

The results can be spectacular. America is filled with tales of people who held jobs as cash-register clerks at Wal-Mart, or on the diaper-making line at Procter & Gamble, who survived on their wages but have made fortunes through steady accumulation of company stock in retirement plans.

The recent implosion of Enron, however, has focused attention on the risks to employees of such non-diversification. More than half of the assets in Enron's employee retirement plan were in company shares that most beneficiaries were not permitted to sell. When the company went bust, people lost their savings as well as their jobs. And Enron is hardly unique (see table). “A lot of companies do this, and it stinks,” says Steven Sass, author of “the Promise of Private Pensions” (Harvard University Press, 1997).

Congress has held hearings, and, if the public outrage continues, it will be hard for it to resist acting. At the least, it should review the sloppy way that retirement plans are regulated by America's Labour Department, a vast bureaucracy.

Pension mismatch
Selected companies

	Shares in company as % of 401(k) assets	Share price performance this year, %
Procter & Gamble	94.7	-2.2
Pfizer	85.5	-12.3
Coca-Cola	81.5	-25.1
General Electric	77.4	-23.3
Texas Instruments	75.7	-34.5
McDonald's	74.3	-22.1
Enron	57.7	-99.1
Ford	57.0	-28.9
Qwest	53.0	-69.7
AOL Time Warner	52.0	-8.1

Sources: DC Plan Investing; Thomson Financial Datastream

Unlike the Securities and Exchange Commission (SEC), which regulates non-pension investing by demanding clear, consistent, and extensive disclosure of risks (including non-diversification) and costs, the Labour Department has wrapped pension investing in confusing laws that provide beneficiaries with inadequate information and limited recourse. Merely raising a question can lead to a Kafkaesque nightmare. “I don't think the Labour Department is equipped to advise millions of people in these plans,” says Arthur Levitt, former head of the SEC. “They are kind of left hanging out to dry.”

Concern that a company's pensions could be inappropriately crammed with the company's own stock are hardly new. In 1942 laws were passed restricting the amount in classic pensions that provided a set payment, known as defined-benefit plans, to 10%. In the 1980s, however, companies moved away from guaranteed pensions, instead offering so-called 401(k) plans, or defined-contribution plans. In these, employees use pre-tax money to invest, with choice typically limited to some mutual funds or their company's shares. Employers often provide some matched funds, frequently through company shares, whose sale can, as in Enron's case, be restricted.

On average, employees at big listed companies keep about one-third of their 401(k) money in the company's shares. Employees may be able to purchase their shares at a discount, but often the main pressure is corporate culture. At Procter & Gamble, employees receive their company shares through a special retirement trust. Nevertheless, although they have many other options and must purchase shares at market prices, P&G shares still account for almost 95% of the company's 401(k) assets. “The welfare of the company and the employee are inseparable,” explains Martha Depenbrock, a company spokesperson. Given recent events, many employees may be having second thoughts about that.

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South Africa's currency

Lead boots

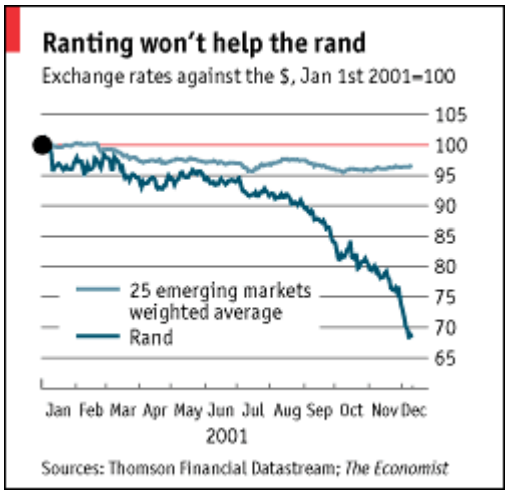
Dec 13th 2001 | JOHANNESBURG
From The Economist print edition

Can traders' prejudice explain the rand's latest slump?

TITO MBOWENI, governor of South Africa's Reserve Bank, likes to crack a joke. He wants a single currency for the continent—to be called the “Afro”. He often promises to quit and “become a farmer”, despite a recent honour from his peers who named him governor of the year. And he is half-serious when he blames the slide of the country's currency, the rand, on traders' ignorance and prejudice.

The rand is certainly the victim of something. It has drifted down in the past decade, as the economy has opened up and most exchange controls have been lifted (a few remain for South African citizens). But the latest slump, to 11 against the dollar, marks a loss of nearly a third of its value since the start of this year (see chart). Most economists say the currency is undervalued, given the steady state of the economy, stable government and widely praised economic policies. No country sells a cheaper Big Mac, according to this newspaper's burger index.

The government and Mr Mboweni angrily blame ignorant currency traders who do not bother to distinguish between African economies, and who are, they say, prejudiced against black African rulers. Traders who cite Zimbabwe's woes as a reason to sell the rand forget that exports across the Limpopo account for just over 2% of South Africa's trade, compared with the nearly half of its exports shipped to rich countries. Indeed, only 13% of South Africa's exports stay in Africa.



And those who mention South African corruption as a worry give the country little credit when the police get tough: after the arrest of Tony Yengeni, chief whip of the ruling African National Congress, in connection with an arms deal, the rand nose-dived. General concerns about AIDS, crime and lingering exchange controls should be outweighed by the government's widely praised macroeconomic policies, they argue.

Are traders punishing the rand and marking down the currency's “true” value? It is one of the most liquid of emerging-market currencies, making it easy to bet against. In an effort to warn off the speculators, Mr Mboweni recently said that his staff would keep a meaner eye on currency movements and would try to punish, with fines, those who were gambling on the rand's decline. But it is near impossible to distinguish which currency trades are needed for business, which for hedges, and which are gambles.

Even bearish traders would struggle to push down the rand—if there were not good reasons for it to drop anyway. Expecting a general decline, many companies and individual South Africans take their money to foreign, often British, bank accounts. Some of the largest companies, such as Anglo-American and South African Breweries, are now listed offshore, pay dividends overseas in hard currency, and delay repatriation of funds to South Africa by up to six months.

Nor have the government or Mr Mboweni—the governor of an independent central bank—done much to fight the rand's fall. In some cases the reverse is true: ministers talk breezily about the boost to exports from a weak currency. The central bank has even been selling rand for dollars to pay off debt incurred in a costly attempt to defend its currency during the Asian crisis of 1998. Foreign investment has slowed to a trickle because of delays in the privatisation of telecoms, the electricity company, the airline and other state-owned businesses. If something were done about that, the rand could rise again.

More likely, before then, Mr Mboweni and his monetary committee may decide to raise interest rates—to stave off inflation, which depreciation may push up, and to protect the rand. That could come soon, but it would threaten growth in an economy that desperately needs more jobs. No joke there.

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About sponsorship

Initial public offerings

Crime and punishment

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What should be Wall Street's penance for the dotcom bubble?

TWO months ago, there were rumours on Wall Street that CSFB was ready to reach a settlement with the Securities and Exchange Commission over irregularities in the sale of Internet initial public offerings. The investment bank would pay a fine of $250m, and offer up on a plate the head of Frank Quattrone, the investment banker who brought many of those IPOs to market. In November, a criminal investigation into CSFB's handling of IPOs by the Manhattan district attorney was dropped. This week, reports suggest that the SEC is ready to agree to a fine of only $100m. (Mr Quattrone's fate is uncertain.) If so, CSFB, which has yet to confirm that a settlement has been agreed, may reckon it has got off lightly. The other eight or more Wall Street firms whose IPO practices are under investigation, including Morgan Stanley and Goldman Sachs, may also be quietly encouraged about their prospects.

CSFB has been accused of allocating shares in IPOs to clients who guaranteed to split with the bank any profits made by selling those shares as soon as the market opened. The client would do this by increasing its trading of other shares, thus generating extra commissions for CSFB. During the dotcom bubble, the price of shares would often soar after an IPO, creating huge instant profits for those able to sell shares allocated at the IPO price.

In the case of VA Linux, the IPO said to be at the centre of the SEC investigation, CSFB priced the issue at $30, and saw it end the first trading day at $239. In that deal alone, over “$1 billion was left on the table” as potential profit from a quick sale by those who were allocated shares, calculates Jay Ritter, an economist at the University of Florida. In 1999-2000, IPOs left a total of $66 billion on the table after their first day of trading, says Mr Ritter.

Reports vary on how much of this potential profit was actually taken by sellers, and how much was farmed back to investment banks through extra commissions. Some hedge funds claim they repaid between one-third and one-half of their profits—though 5-15% may have been more typical. Even so, it is conceivable that CSFB made more than $100m on the VA Linux flotation alone. The bank still faces numerous lawsuits from disgruntled investors, who claim to be victims of this system of allocation.

Though reaching a settlement with the SEC (albeit with no admission of wrongdoing) would weaken CSFB's claims of innocence, those who bought shares will be hard pressed to prove actual harm: there is no evidence that a system of recycling profits to IPO underwriters inflates the price of a share. More obviously, it might temporarily underprice it, in order to ensure a decent first-day jump. In which case, the firms whose shares were being sold might have a claim that they were unwittingly ripped off by their underwriter—yet, surprisingly, no issuer has yet brought a lawsuit on these grounds.

CSFB is not alone in facing private legal actions. Plaintiffs have filed more than 1,000 lawsuits against some 40 investment banks. Law firms are salivating over the possibility of draining the reserves of every Wall Street firm. Most of these cases concern a practice known as “laddering”: in return for being allocated, say, 10,000 shares at the IPO price, the investor promises to buy additional parcels of shares in the aftermarket at various higher rungs on the price ladder. The plaintiffs allege that this artificially inflated prices in the aftermarket, fooling investors into buying shares at prices they thought were set by market forces—until they saw prices plunge soon after. Others might conclude that anybody willing to pay what so many investors did for obviously useless dotcoms has only himself to blame. See you in court.

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Russian stocks

Zombie shell-game

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Even dead companies can attract live investors

THEIR names may live in financial infamy, but then a sucker is born every minute. Two of Russia's most notorious bust banks, a bankrupt oil company and a dodgy construction firm attract no interest among the hard-bitten brokers in Moscow. But in the fevered world of German small investors, they are still hot stocks.

The four companies—all, in effect, bankrupt shells—are traded on Newex, a specialist Austrian-German bourse for Central European shares. Every now and then their prices rocket or slump. “I can give you no idea why people are buying those shares: it is not for us to know or judge,” says Lars Hofer, a Newex spokesman.

So why is an otherwise respectable exchange trading stocks that, in effect, do not exist? One shell company, Chernogorneft, helpfully lists its cashflow for the past year as “nil”. Mr Hofer admits that the shares are “pure speculation” but insists, a touch defensively, that “trading shells is common on every stock exchange”. The four companies are, for example, traded in largely unregulated over-the-counter dealings in North America.

The shares' activity is due to pyramid schemes. These ramp up prices of obscure stocks to attract gullible investors, then dump them, leaving the organisers with a profit and the suckers with a loss. The stellar performance of (real) Russian stocks this year helps the spin. The pyramid outfits warn punters not to believe Moscow-based brokers (who are aware of their scam) because all advice from Russians is untrustworthy. Not like those reliable Austrians and Germans.

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Economics focus

Double or nothing

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Fixing failed firms should be based on economics, not revenge

THE collapse of Enron, the largest bankruptcy in American history, has rung out a banner year for American business failures. In Europe, the fallout from the Swissair and Sabena insolvencies continues. In the current global slump, more companies are likely to go under. Now is a perfect time to reconsider how to handle such failures: let them sink, or give them a chance to swim?

In America, bankruptcy has come to mean a second chance for bust businesses. The famous “Chapter 11” law aims to give a company time to get back on its feet, by shielding it from debt payments and prodding banks to negotiate with their debtor. It even allows an insolvent company to receive fresh finance after it goes bust.

On the other side of the Atlantic, when companies stumble, almost as much effort is spent in fingering the guilty as in trying to salvage a viable business. British and French laws, for example, can make a failing company's directors face criminal penalties and personal liability. Moreover, bankers have the power, at the first sign of trouble, to push a company into the arms of the receivers. Some modest changes are afoot, however. Britain is considering moves that would bring its rules closer to America's. New laws in Germany should also make it easier to revive sick companies, although trade unions still have their say.

But even with the arrival of the euro and moves towards a single financial market, going bust in Europe is a strictly local affair. Long before America had a single currency, the American constitution provided uniform bankruptcy laws, observes Elizabeth Warren of the Harvard Law School. Europe's patchwork of national laws, according to Bill Brandt of Development Specialists, a consultancy, inhibits lending and makes it difficult to fix ailing firms.

Transatlantic insolvencies are even harder, as a Belgian-based software company, Lernout and Hauspie, discovered this year. Its American reorganisation plan was thwarted by a Belgian judge, who ordered a sale of the firm's assets. As the European Union inches toward greater harmonisation, should it try to mimic America?

Critics of Chapter 11 think not. They argue that America's bankruptcy system is wasteful, lets failed managers go unpunished, and gives some companies an unfair advantage. In Chapter 11, admittedly, lawyers and advisers gobble up fees, but a recent study argues that the fees are no larger than those for most mergers and acquisitions.

One common complaint, that managers enjoy the high life while creditors go begging, fails to stand up to the data from America's previous wave of bankruptcies in the early 1990s. Stuart Gilson of the Harvard Business School found that more than two-thirds of top managers were ousted within two years of a bankruptcy filing. More troubling is that some American firms seem to enjoy second and third trips to bankruptcy court, cheekily termed Chapters 22 and 33. Some see this as evidence that, too often, they use Chapter 11 to keep running. But there is more to the story.

Seen and unseen

The difference between Europe and America, points out Professor Gilson, is the choice between two types of mistake, which economists call type I and type II errors. Both are familiar to any courtroom. Type I errors are caused by excessive caution: for example, the court that lets a guilty defendant go free. Type

II errors result from excessive zeal: for example, the court that convicts an innocent who is wrongly accused.

America's generous approach to bankruptcy creates type I errors. It occasionally revives firms that should be shut. For example, Eastern Airlines flew for years under Chapter 11, free of its rivals' interest costs. Another airline, TWA, went bust three times before it was at last taken over.

Less visible are the failures of the European system, which are of the type II variety. Companies that might have been revived are prematurely put down, often amid fire sales. Like a negligent doctor, a strict bankruptcy system buries its mistakes. Ironically, this can work against Europeans' oft-stated goal to preserve jobs; a company might be able to survive with reduced debt.

Given the relative merits of the two types of mistake, Europe's steps towards a Chapter 11 regime should be praised. This is especially true since most of the (type I) costs in Chapter 11 are borne by private creditors and shareholders, not by governments. The European approach has frequently resulted in state subsidies, rather than in creditors taking it on the chin. Consider this year's bankruptcy of Moulinex, an appliance maker, which the French government tried to prop up when creditors, exercising their legal rights, refused to negotiate.

The American system is far from perfect, however. It has failed to bring badly needed consolidation to the steel industry. Failed dotcoms also highlight the flaws, since many have sought to reorganise without much hope of ever producing profits. In general, however, more than nine out of ten companies entering Chapter 11 eventually liquidate—the lucky few that survive account for the most jobs and economic value.

Mr Brandt points out that the two strongest forces in a bankruptcy are money and revenge. In America, where failure has long been a routine part of the entrepreneurial culture, the emphasis is on money. European law tends to favour revenge. A pity that the different outcomes are so stark.

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The origins of racism

Them

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Reuters

Racial discrimination may be easier to eradicate than was previously thought

IN THE bad old days of 19th-century eugenics, scientists who had supped at the table of social Darwinism would construct evolutionary trees that had twigs within the species *Homo sapiens*. Each twig was a racial group. The top twig was, of course, the white Caucasian one—since the scientists who did this work were themselves white Caucasians.

Modern genetics has shown the error of their ways. Systematic genetic differences between people from different parts of the world, though they exist, are small compared with variations between people from the same place. The visible differences, such as skin colour, are the result of a mere handful of genes. Under the skin, humanity is remarkably homogenous.

Racism, however, is ubiquitous. It is not only white Caucasians (whatever that term means, in the context of current knowledge) who are guilty of it. That has led to another biological hypothesis, that people are somehow “programmed” to recognise race and be racist.

Robert Kurzban, John Tooby and Leda Cosmides, three evolutionary psychologists who work at the University of California, Santa Barbara, find this hypothesis unlikely. And this week they have published a paper in the *Proceedings of the National Academy of Sciences* that supports an alternative hypothesis.

That hypothesis is that racism is actually an unfortunate by-product of another phenomenon—a tendency to assign people to “coalition groups”, and to use whatever cues are available, be they clothing, accent or skin colour, to slot individuals into such groups (or “stereotype” them, as modern usage might term it). The good news is that experiments done by the researchers suggest that such stereotypes are easily dissolved and replaced with others. Racism, in other words, can be eliminated.

You want to be in my gang?

For many years, psychologists have believed (and have found data to support) the idea that, when somebody encounters a stranger, the stranger's characteristics are slotted into three pigeon-holes: sex, age and race. These pigeon-holes are assumed to be long-established, biologically programmed mental faculties.

The sexes and ages of other people are social contexts in which decisions have to be made all the time, so the idea of evolved pigeon-holes to deal with these categories makes sense. The reason for scepticism about the third category is that, for most of their evolutionary history, human beings would never have been exposed to individuals of other races. It is therefore hard to see how a specifically racial pigeon-holing system could have arisen.

On the other hand, there was probably good reason to want to be able to place a stranger within the system of tribal groups, coalitions and alliances that early man would have had to deal with among his neighbours. To the extent that the individuals in those groups had things in common, those things might mark an unknown individual as a group member.

Learning the wrong associations between markers and groups, though, would be maladaptive, so a flexible approach to such markers, discarding them when they prove useless, might be expected. Following this line of thinking, Dr Kurzban, Dr Tooby and Dr Cosmides predicted that, in circumstances in which race was irrelevant to the ways that groups of allies form, prejudice would vanish, possibly rapidly.

To test this idea they used an established psychological technique called the “memory confusion protocol”. This involves showing subjects a series of photographs of people, together with sentences of a conversation that those people are supposed to be having.

After that (and without having been warned what to expect) the subject is shown the sentences in a random order, and asked who said what. The information the protocol provides stems from misattributions of words to pictures. Subjects tend to confuse who said what within groups that they have constructed mentally from the information available, rather than between those groups. But the only data available to construct those groups are the words and pictures, so the researcher can work out which criteria are, perhaps unconsciously, being used.

Dr Kurzban, Dr Tooby and Dr Cosmides used two variations of the protocol. In both, the photographs (all of young men) were assigned by computer to one side of the conversation or the other, with each side receiving two black and two white men. In the first variation, the content of the conversation was the only clue to coalition membership. In the second, the individuals on either side wore different-coloured shirts (grey and yellow).

The researchers made four specific predictions: that race would not be “encoded” into a subject's reactions equally in all social contexts; that shared appearance is not necessary for encoding membership of a coalition; that arbitrary cues other than race can assume the properties that race tends to exhibit in predicting membership of a coalition; and that, when that happens, the strength of racial stereotyping will drop. All of these predictions were shown to be correct.

In the first experiment, in which there were no visual clues about coalition membership, a lot of misattribution was correlated with skin colour. However, such misattribution was not overwhelming. Subjects misattributed statements on the basis of which side of the conversation they came from about half as often as they did on the basis of race; appearance is therefore not everything.

It is, however, important. In the second experiment, the results were reversed. Given the extra clue of shirt colour, the preponderance of misattribution was connected with apparent membership of a coalition. Race dwindled into insignificance.

The subjects had been given no prompting about the purpose of the experiment. They did not know that they were supposed to be looking for coalitions. But, subliminally, they noticed them anyway. That suggests their brains were more attuned to clustering by signals that would point immediately to group membership, than by prejudices about which individuals should be forming groups. In turn, that suggests that racial characteristics are operating merely as badges of convenience, rather than pressing deep, biologically determined buttons of discrimination. And that, though by no means a solution to the problems of racially divided societies, might provide a small chink for social policy to work on.

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Malaria vaccines

Unintended consequences

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No vaccine at all may be better than an imperfect one

ACCORDING to the World Health Organisation, malaria kills about 3,000 people a day, as many as 70% of them children under the age of five. Many groups of researchers are working on vaccines against the disease, but most agree that any vaccine that results will be imperfect. Nobody is expecting to confer full immunity with a vaccine, because the organisms that cause malaria are not viruses or bacteria (the traditional targets of vaccination) but single-celled animal-like creatures. These are a lot more complex and diverse than traditional vaccine targets. It is therefore hard to prime the immune system against all the strains of them that may cause the disease.

That might not be thought to matter much, on the basis that some protection is better than none. But a paper by Sylvain Gandon, Margaret Mackinnon and their colleagues at the University of Edinburgh, published in this week's *Nature*, shows that this ain't necessarily so. Partially effective vaccines may end up doing more harm than good. The researchers' mathematical models suggest that such vaccines may provoke the evolution of particularly virulent strains of the pathogen that causes the disease.

To understand why an imperfect vaccine might increase a disease's virulence, consider the matter from the pathogen's point of view. The main cost of increased virulence is that it will shorten the lifespan of the host, reducing the chances of the disease being transmitted to new hosts. On the other hand, a pathogen benefits from increased virulence because pathogenic organisms that are more virulent are less easily defeated by a host's immune system. That means that once a pathogen gets into a new host, it has a better chance of establishing itself.

In nature, the balance between these two forces is what governs the virulence of a given disease. The effect of a vaccine that confers full immunity, from the pathogen's point of view, is to reduce the size of its host population, since only unprotected individuals can then be infected. If anything, that will tend to reduce virulence, since the pathogen will have to hang on longer between transmission opportunities, and so will “want” its host to survive. But a vaccine that confers only partial immunity will increase host survival anyway, allowing pathogens that are not affected to “bank” this increased survival by becoming more virulent themselves.

This means two things. First, in the long run, the vaccinated will be no better off than they would otherwise have been. Second, the unvaccinated are actually worse off, since the newly virulent strain will spread at the expense of the older, less virulent ones. That is something that policymakers need to consider carefully if and when they are presented with a vaccine against malaria.

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Cosmology

Gravity's elusive ripples

Dec 13th 2001
From The Economist print edition

Why spend huge sums on experiments not expected to produce any results?

IMAGINE buying an expensive new telescope and setting it up in a remote spot. You would be pretty disappointed if you couldn't see anything with it, especially if you were expecting it to give you a complete new view of the universe. But that is exactly what some American astrophysicists expect to happen when they start collecting data from a new kind of telescope at the end of this month.

Their $365m observatory, called LIGO, is not built around a huge mirror or a vast dish. Instead, it consists of two pairs of 4km-long metal tubes, located more than 3,000km apart in the states of Washington and Louisiana. It is designed to look not for light or radio waves, but for gravity waves. These have never been seen directly, although their existence was predicted by Einstein in 1916.

Gravity waves should occur whenever a mass is accelerated. Although an accelerating human-sized, or even earth-sized, object would produce infinitesimally small gravity waves, the waves that emanate from, say, the collision of two black holes ought to be detectable. So should echoes from the Big Bang with which the universe is believed to have begun. And, whereas radio, light and other forms of electromagnetic radiation are easily absorbed by such things as dust and gas, leaving much of the universe hidden, gravity waves will penetrate anything in their path.

LIGO (the Laser Interferometer Gravitational Wave Observatory), and a number of similar projects, exploit the fact that gravity waves should cause space to stretch in one direction and shrink at 90° to this direction. The tubes in each detector are set at right angles. A laser beam is split, sent down each tube, and bounced off a mirror at the end of the tube. The two components of the beam are arranged so that, when they arrive back at the beam-splitter, the peaks of the waves of one are in step with the troughs in the other. They therefore cancel each other out, and a detector placed behind the beam-splitter registers darkness. A gravity wave passing through the system should stretch one tube and contract the other, ending the neat alignment of peaks and troughs and registering light in the detector.

Strength in numbers

LIGO's operators will, however, be wary before claiming to have seen a gravitational wave. In 1974 Russell Hulse and Joseph Taylor recorded an indirect sighting when they showed that a pair of stars spiralling towards one another were radiating gravity waves at exactly the rate predicted by Einstein. That won them a Nobel prize. But a direct sighting of the waves has eluded physicists. In the 1960s, Joseph Weber of the University of Maryland claimed that an aluminium bar he had set up for the purpose was set ringing by a gravitational wave, rather like a wine glass that shatters at just the right frequency. But subsequent experiments did not support his claim, and the discipline's entire reputation was tainted.

Interferometers such as LIGO are more likely to spot a gravitational wave than was Dr Weber's bar detector, because they are sensitive to a broader range of gravity-wave frequencies. But in practice it will still be devilishly hard to detect a wave, even in an interferometer.

A passing gravitational wave will make only a tiny change in the relative lengths of the tubes. This means that the interferometers' arms must be as long as possible, with the beam reflected back and forth along each arm to double the path length. Even so, the expected difference in length between the paths amounts to less than a hundred-millionth of the diameter of a hydrogen atom.

This requires that even the minutest movement of the mirrors be eradicated. The tubes are therefore evacuated, so the mirrors cannot be pushed around by air molecules, and the mirrors themselves are

hung on fine wires to isolate them from heat and from vibrations in the earth.

On top of all this, researchers hope that by having several interferometers around the world they can confirm possible signals as real gravitational waves (a wave from space would pass through the whole earth) rather than “noise”. They would also be able to compare a wave's arrival time at different instruments, and work out what direction it came from. So, when LIGO starts taking test data on December 28th, it will do so in parallel with an interferometer in Hanover, known as GEO600, that has been built by scientists from Germany and Britain.

As this instrument's name suggests, its arms are only 600 metres long, but it has about the same sensitivity as LIGO because it incorporates more modern technology, such as fused-silica wires to hang the mirrors (these reduce heat flow that might induce thermal vibrations). At $7m, it is also a lot cheaper than LIGO.

LIGO and GEO600 are due to start taking real data early next year. They will be joined in 2003 by a joint Italian-French interferometer called VIRGO being built in Pisa. The 300 metre TAMA detector near Tokyo is already up and running.

And yet there remains a big problem. As Kip Thorne of the California Institute of Technology, one of the founders of the LIGO project, admits, LIGO is unlikely to see any gravity waves at all until it is upgraded. Despite its humungously long arms, it is just not sensitive enough. Moreover, that lack of sensitivity was clear from the beginning of the project.

Some people might therefore regard LIGO as a complete boondoggle. Dr Thorne disagrees. He says it is important to get experience with a more modest LIGO before upgrading. And it is possible that he is wrong, and that gravity waves will be powerful enough for LIGO to detect after all. But that would probably mean Einstein was wrong, too. Who would you bet on?

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Robotics

Having a ball

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Spherical robots have many advantages

OVER the next four months, Ranjan Mukherjee, a mechanical engineer at Michigan State University, will be putting the finishing touches to his latest invention: a spherical robot that will, according to Dr Mukherjee, be a unique platform for mobile machines. A sphere has many advantages over a wheel. It is more stable, it is capable of rapid manoeuvres and movement, and it can roll in any direction. As a consequence, it has less trouble traversing rough terrain.

The robot moves by shifting internal weights. These weights are pushed up and down by motors on three inner spokes. The movements of the weights create the internal imbalances that make the sphere roll. When a weight is pushed out on a spoke, the sphere moves in that direction. Once the weight is at the bottom, it can be retracted without causing further movement.

There is, though, another clever thing about the robot—it can be made to arrive at a particular spot the right way up. If, say, it is a battlebot that is designed to extrude a set of periscopic eyes, telescopic tripod legs and a gun when it has stopped rolling, it must stop with its eyes on the “top” of the sphere, its “feet” at the bottom, and its gun somewhere in between. A ball rolling in a straight line from one place to another will not do this. Instead, the robot must roll in a wiggly line. Calculating this “wiggle” turned out to be a tricky mathematical problem, but it is one that Dr Mukherjee says he has solved.

One drawback of the sphere is that it cannot climb hills—slopes steeper than about 12° are likely to flummox it. But who knows what might be possible in the future? Another of Dr Mukherjee's inventions is a robot with suction-cup feet that can climb up walls.

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About sponsorship

Saint Catherine's monastery

Heaven's gate

Dec 13th 2001 | SINAI DESERT, EGYPT
From The Economist print edition

The newly opened sacristy at Saint Catherine's monastery is one of the world's most enchanting small museums

WHEN Saint Anthony, the father of eastern Christian asceticism, withdrew to the Egyptian desert from the hustle, bustle and sophistication of the late Roman world, he insisted that he had no need of books. It was not just the corruption and decadence of urban society that he was renouncing, but the formal culture that went with it.

Paradoxically, though, the most tangible legacy of the desert monastic tradition is a unique repository of high culture and scholarship: the library, icons, textiles and religious artefacts of Saint Catherine's monastery on Mount Sinai. A glimpse at some of the 3,500 bound manuscripts and 2,000 scrolls and fragments, as well as more than 5,000 early printed books, that are housed in this granite fortress is enough to prove that not all Saint Anthony's successors shared his vocation to renounce the written word. Among ancient libraries that have survived to the present day, the Saint Catherine's collection is of an age and diversity (above all, linguistic diversity) that only the Vatican can match.

The bone-dry desert, moreover, has played a vital role in ensuring the survival of the monastery and its treasures—some of which have been made a bit more accessible to the secular public with the opening, last weekend, of a gorgeous little sacristy tucked into one of the monastery's vast stone walls. With about 30 icons—including the sixth-century painting of Christ which is always associated with this monastery—and 20 of the most important books and manuscripts on display, this dimly-lit, low-ceilinged gallery, divided into seven tiny rooms, will take its place among the finest small museums in the world. The parchments on show include fragments of the Bible, and religious works in Georgian, Slavonic, Latin and Syriac as well as Greek.

Christian texts in Arabic (or in some cases, Greek and Arabic side by side) provide tantalising evidence of the process by which Christian subjects of the fast-growing Muslim empire began to worship, and theologise, in the language of their new political masters. Also on view are a couple of pages from one of the oldest surviving manuscripts of the Bible, the Codex Sinaiticus, dating from the fourth century.

These folios were found in the monastery's north wall in 1975. They partly (but only partly) make up for the fact that most of the Codex is in London; a 19th-century German scholar persuaded the monks to lend him the priceless manuscript, and he passed it on to the Russian tsar. It was later purchased from the Soviet authorities by the British Museum.

For diplomatic reasons which are as pressing in the 21st century as they were in the seventh, particular prominence is given to a copy of the *achtinames*—a document said to bear the handprint of the Prophet

Muhammad, along with his acceptance of the monks as worthy residents of the mountain. Sinai came under Muslim rule in 641, about a century after the community's foundation.

The opening of the sacristy is one of several projects through which today's 25-strong Orthodox Christian fraternity is attempting, with considerable subtlety, to solve an almost insoluble problem. How can they open up to the outside world—which longs for greater access to the monastery's treasures and is keen to offer scientific and historical expertise in return—without disturbing the inner life of a community whose ultimate purpose is not the production, or preservation, of beautiful artefacts, but communion with God?

Half a century ago, when reaching the monastery meant a camel ride of many days—and the monks had little idea of the wars raging in the outside world—preserving the community's privacy and integrity was less of a problem. But in recent years, with busloads of tourists braving the three-hour drive from the Red Sea resort of Sharm-el-Sheikh, the outside world could not be kept at bay. Nor could scholars, who wanted to view and help preserve the monastery's treasures, be ignored.

One part of the solution—in the view of Archbishop Damianos, the monastery's shrewd and genial master—will be provided by digitally photographing much of the library and making it available in electronic form at a soon-to-be-completed research centre in Greece, the homeland of most of the monks.

There is also a long-term conservation project which has attracted the support of some up-market benefactors in London, Geneva and New York, who set up the Saint Catherine Foundation. With their help, a team of conservators has begun a two-year effort to assess the state of the book and manuscript collection; this will be a prelude to refurbishing the library and protecting its contents from deterioration by storing manuscripts in specially-designed boxes. The whole enterprise is expected to last about a decade; it is intended to stabilise the library's condition for many years to come.

Book conservation at the monastery poses some unique problems. The arid air is a wonderful guarantee against mould and insects, but it also makes parchment brittle; some tightly-rolled scrolls can hardly be opened without the risk of breaking them. If dry parchments are suddenly exposed to greater humidity, long-dormant spores will start sprouting. To ensure their survival, vulnerable scrolls will have to be unrolled in a workshop and then re-rolled on to larger cores.

What would Saint Anthony have made of it all? Or the monastery's founder, Saint John of the Ladder, whose call to self-denial and spiritual warfare has been a sort of manifesto for monks ever since?

The looming encounter between modern technology and a timeless spiritual tradition might indeed pose an almost insuperable challenge for the latter if Saint Catherine's were located anywhere else. But the weird beauty of Sinai's red rock, whose colour seems to change by the hour, may guarantee the monastery's spiritual integrity; it has an extraordinary effect on people of all persuasions. In this world of splendidly dark nights, bright stars and brilliant sunrises, at once benign and terrifying, even the dullest of souls can feel the urge to reflect in new ways about the relationship between the transitory and the eternal.

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About sponsorship

Theatre history

King David

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DAVID GARRICK'S name lingers longer and stronger than almost any of his celebrated contemporaries. His exquisite bedroom furniture—by Chippendale—is to be seen in the Victoria and Albert Museum's splendid new British Galleries, a West End theatre bears his name, as do a gentlemen's club and a London street. But Jean Benedetti tells us that Garrick's real legacy is an English style of acting, so influential that he would recognise it still.

David Garrick and the Birth of Modern Theatre
By Jean Benedetti

Methuen; 252 pages; £20

Buy it at
Amazon.co.uk

When he first played Richard III, Garrick was 24 and his revolutionary potential was clear for all to see. “Mr Garrick shone forth like a theatrical Newton,” wrote one critic. Garrick had been brought up in Lichfield, but there was precious little money in the family, who were originally Huguenot refugees from France. When he arrived in London he had precisely three ha'pence in his pocket, but he had a priceless asset in his companion in the weary walk from Lichfield—Dr Samuel Johnson no less, who had taught him Latin and Greek, and who never ceased to encourage and admire him. The Lichfield Two are a wonderful example of 18th-century social mobility. Garrick travelled with Lord Burlington and William Cavendish, who became prime minister; he sat for Reynolds and Gainsborough; Sheridan was chief mourner at his funeral; and for the last 20 years of his life his best friend was Edmund Burke.

Garrick's fortune came from his management of the Drury Lane theatre, but he was famous because of his acting. His talent to amuse had been noticed in Lichfield, and when he arrived in London his determination to act was driven only partly by the failure of the wine merchant's business he ran. Garrick was a force of nature. He was compelled to act, and his first stroke of luck was that he picked up no bad habits from teachers.

In the early part of the 18th century actors stood still and declaimed. Garrick's first Richard III was noticed for its “easy, familiar, yet forcible style.” From the start, he was different and compelling. His Hamlet was so striking that Mr Benedetti forgives him for rewriting the climax, and making it a happy ending.

Mr Benedetti, who has acted, directed and also taught, is at his best when he is defining the attributes that made Garrick great. The first was technical mastery, which was achieved through hard work (he advised young actors not to waste time in clubs). The second is harder to define, but it seems to be the ability to infiltrate his own personality into a part. He could be true to a variety of characters while remaining recognisably Garrick. It was an attribute that Olivier, Gielgud and Richardson all brought to the English stage. Mr Benedetti calls them “Garrick's children”. And they keep on coming: Judi Dench, Ian McKellen and Michael Gambon too.

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J.R.R. Tolkien

Lord of the box office

Dec 13th 2001
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A new biography illuminates Tolkien, the creator

This one's for Harry

JOHN RONALD REUEL TOLKIEN had little patience for the trappings of modern life—he gave up his car, avoided television and frowned on modern literature and arts. Fiercely protective of his work, he might well have blanched at the new $300m Hollywood adaptation of his classic fantasy trilogy, “The Lord of the Rings”, the first instalment of which opens next week.

“Tolkien”, a timely biography by Michael White (Little, Brown, £16.99), recounts the writer's lifelong pursuit of a “mythology for England”. Following a wartime bout in the trenches, Tolkien arrived at Oxford in 1925 as a lecturer in Anglo-Saxon. Concerned that England lacked a set of myths comparable to, say, the Norse legends, he created the fantasy realm of Middle-earth, home to a jumble of orcs, elves, wizards and hobbits. “The Hobbit” appeared in 1937; nearly two decades and many reworkings later came “The Lord of the Rings”, and later still, after his death, its near-impenetrable companion, “The Silmarillion”.

At Oxford Tolkien kept company with the Inklings—a clutch of dons who gathered on Tuesday mornings at a pub to read their work aloud. There Tolkien and C.S. Lewis tried out drafts of “The Lord of the Rings” and “The Lion, the Witch and the Wardrobe”. Though Tolkien, a Catholic, helped reconvert Lewis to Christianity after his atheist years, it is Lewis's fantasy world, not Tolkien's, that radiates Christian allegory. Both writers' books, though, came to exert a powerful appeal to both children and adults alike—one matched today by J.K. Rowling's Harry Potter series. Much of the ground covered in this biography will be familiar to Tolkien devotees, but Mr White's virtue lies in making his subject seem both accessible and fun: another boost for the Ring around Tolkien.

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New thrillers

Smokin' reads

Dec 13th 2001
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Character is what makes these thrillers

THANKS to some computer-hacker friends, Matthew Scudder enjoys free long-distance phone calls from his office. “I suppose stealing is stealing,” he muses, “whether it's the phone company or a blind newsboy you're ripping off, and I'm sure moral relativism is philosophically unsustainable, but what the hell, nobody's perfect.” For anyone who hasn't met him before, there you have Matt Scudder in a nutshell. The hero of 15 books by Lawrence Block, Scudder is a winningly smart-assed private eye who can shoot the breeze (and the bad guys) with the best of them, and has a capacity for abstract thought to boot.

“Hope to Die” opens with the brutal murder of a middle-aged couple in their ritzy Upper West Side brownstone. The killers are quickly tracked down, and no obvious loose ends are left dangling. As far as the cops are concerned, the case is closed. But Scudder is not convinced. With plenty of spare time on his hands, he decides to do a little snooping of his own. His hunch proves well founded: the real killer is still at large, and poised to strike again.

A murderous psychopath, though, is not the only thing on Scudder's mind. The unexpected death of his first wife and his awkward relationship with their two sons are also cause for sleepless nights. It's Mr Block's willingness to give his hero a bit of extra psychological depth—to show that he's really just an ordinary Joe with problems of his own—that makes his Matt Scudder books so satisfying.

Sara Paretsky's feisty Chicago-based sleuth, V.I. Warshawski, is another wonderfully three-dimensional and sympathetic creation. In “Total Recall”, V.I. is hired to find out whether an insurance company has cheated a poor black man of his life insurance pay-out. Her investigation coincides with protests from the families of Holocaust victims who believe that the company trades in the blood of their forebears. Added to all this, the media spotlight is suddenly thrown on to a man who claims to have realised, under hypnotherapy, that he is a Holocaust survivor. V.I.'s friend Lotty Herschel is enraged by what she sees as his shameless exploitation of Jewish history. Lotty's traumatic experiences in the past, it turns out, provide some important leads for V.I. in her current case.

Despite the unlikely-sounding subject matter, Ms Paretsky dexterously intertwines these separate narrative threads. She also brings an admirable lightness of touch to what might otherwise have been a sentimental story. V.I. cracks wise, even under pressure—as when, baby-sitting for friends, she reflects: “The private eye as baby-sitter: it wasn't the first image you got from pulp fiction. I don't think Race Williams or Philip Marlowe ever did baby-sitting, but by the end of the morning I decided that was because they were too weak to take on a five-year-old.”

The narrative sophistication of “Total Recall” is entirely absent from Robert B. Parker's latest offering. Mr Parker eschews storytelling gimmicks of any kind. Exposition? Forget it. The most you can expect by way of scene-setting here are occasional keen-eyed observations by Jesse Stone, the hero, of the women who cross his line of sight. One example: “Jesse watched her as she went. She was small and in shape. The blue uniform fit her well. The service pistol looked too large. He knew she was sensual: the way her eyes were. The way she stood. The way she walked. He knew. And she knew he knew.” Stone's tongue may be on the floor, but Mr Parker's is firmly in his cheek.

Total Recall
By Sara Paretsky

Delacorte Press; $25.95. Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Total Recall
By Sara Paretsky

Delacorte Press; $25.95. Hamish Hamilton; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Death in Paradise
By Robert B. Parker

Putnam; 304 pages; $23.95. John Murray; £16.99

Buy it at
Amazon.com
Amazon.co.uk

Hostage
By Robert Crais

Doubleday; 380 pages; $24.95. Orion; £12.99

Buy it at
Amazon.com
Amazon.co.uk

As in the novels of his contemporary, Elmore Leonard, Mr Parker's characters come alive in speech. “Death in Paradise” is full of talk, but nothing is talked up—understatement is all. The story is plainly told, without flashbacks, jump cuts, outbursts of Technicolor violence or implausible last-minute twists. This is simplicity itself, and it works a charm.

The focus is even tighter in Robert Crais's “Hostage”. Three bored young punks set out to rob a convenience store in a quiet Los Angeles suburb. Things go wrong the minute they step inside. The storekeeper is accidentally shot, and, after a frustrated escape attempt, the gang finds itself holed up in a nearby house, with three hostages, a father and his two children. Jeff Talley, a former negotiator with the Los Angeles Police Department, is plunged back into precisely the kind of high-pressure situation that drove him out of the city in the first place, and which contributed to the breakdown of his marriage.

The minimal elements of his story in place, Mr Crais tightens the screws with wicked aplomb. The tension is superbly sustained over the course of the novel. And when Talley learns that the house belongs to the chief accountant and money-launderer for the LA mob—who are, of course, extremely eager to retrieve their cooked books before the police move in to rescue the hostages—things start to get *really* interesting.

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Enzo Ferrari

Dark horse

Dec 13th 2001
From The Economist print edition

Enzo Ferrari
By Richard Williams

Yellow Jersey Press; 144 pages; £18

Buy it at
Amazon.co.uk

ENZO FERRARI is not well known outside Italy. Even as his cars were racing to victory all over the world, the man at the helm of the eponymous racing team preferred to stay in Modena and watch the races on television at home. This intimate account of Ferrari's early days and his emergence as the spirit behind the team fills the gap neatly.

Ferrari, now owned by Fiat, has long been synonymous with Formula One racing. Over the years, McLaren, Benetton and Williams may between them have won more races, but it is the glamour as well as the singular success of Ferrari that draws the crowds. As a young man Ferrari had neither the money nor the killer instinct to become one of the great racing drivers. “If you want spectacular results, you have to know how to treat your car badly. The fact is I don't drive just to get from A to B. I enjoy feeling the car's reactions, becoming part of it. I couldn't inflict suffering on it.” What Ferrari liked was to be “an agitator of men”.

The first Ferrari team raced Alfa Romeos, though the partnership did not last. In 1947 Ferrari relaunched on his own, making the first of the cars that would wear the badge of the black prancing horse on a yellow background. By the early 1950s, in the hands of such drivers as Alberto Ascari and Juan Fangio, Ferraris were leading the world championships. Meanwhile, Luigi Chinetti, a great salesman, persuaded Ferrari that road versions of the cars would sell well to rich Americans. In Italy road Ferraris became the film star's must-have car in Cinecitta. Roberto Rossellini even got to drive one in the famous Mille Miglia before his wife, Ingrid Bergman, persuaded him to abandon the race halfway through in Rome.

The accounts of early races, such as the Mille Miglia, from Brescia to Rome and back, and Tazio Nuvolari's win in a Ferrari-run Alfa Romeo at Nürburgring in Germany in 1935, are among the highlights of Richard Williams's book. As the Italian crossed the winning line, Hitler's sports minister ground his teeth and crumpled his prepared speech lauding a Mercedes victory. Mr Williams is a talented writer; he loves Italy and motor racing, and his passion for both shines through.

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The year's best classical CDs

Singing stocking fillers

Dec 13th 2001
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There were surprises all round for devotees of classical music in 2001

WHAT would Verdi have made of the modern recording industry? There are dozens of new CDs marking the centenary of his death, and none better than a collection of his neglected sacred works. It includes the first recording of the “Messa di Gloria” by the Giuseppe Verdi Choir of Milan conducted by Riccardo Chailly (Decca 467 280-2). The soloists include Juan Diego Florez, a young Peruvian tenor with a growing reputation.

Another centenary that has brought some neglected music to public attention is that of Gerald Finzi. One of his last works, a cello concerto that was first performed in 1955, the year before his death, is given a vivid new outing by Tim Hugh with the Northern Sinfonia conducted by Howard Griffiths. (Naxos 8 555766). Finzi combines an unmistakably English, pastoral influence with a bleakness that seems to depict both the composer's own mortality and the weary lessons of the immediate past. The CD also includes some of Finzi's piano works, eloquently played by Peter Donohoe.

An earlier composer only now being rediscovered is a 16th-century Flemish choirmaster, Nicolas Gombert. His “Magnificats 1-4”, are said to have been composed while he was imprisoned on a galley, but they so pleased Emperor Charles V that he had the composer released. The Tallis Scholars directed by Peter Phillips give a spectacular performance (Gimell CDGIM 037).

There was a time when the music of Leos Janacek was largely neglected, though he has moved now to the forefront of 20th-century composers. His dramatic cantata, “The Diary of One Who Disappeared”, is performed by Ian Bostridge, a rising British tenor, and accompanied by Thomas Adès (EMI 5 57219 2). Mr Adès also plays a selection of Janacek's piano music on this CD. The “Diary” is one of the strangest, most haunting vocal works. Floating somewhere between the world of the opera house and *Lieder*, it reaches peaks of intensity that Janacek would later achieve again in “Vec Makropulos”.

Roman Trekel, a baritone, reminds us of the importance of Siegfried Wagner in a recital of scenes and arias, with the WDR Symphony Orchestra of Cologne under Werner Andreas Albert (CPO 999 684 2). Like many sons of famous fathers, Siegfried Wagner suffered from living in Richard's shadow. Some of his music seems like a conscious parody of the Wagner style, yet it has a feel of its own that looks forward to more modern forms.

If opera composers often despair of Wagner's influence, the place where his music was most parodied was mid-century Hollywood. Once virtually disdained by musicians, Bernard Herrmann is enjoying a revival. His scores for “The Snows of Kilimanjaro” and “5 Fingers” are played by the Moscow Symphony Orchestra conducted by William Stromberg (Marco Polo 8 225168). There is still some resistance to acknowledging the importance of film music, but for those with more eclectic tastes this highly dramatic and effective repertoire can be exhilarating.

Daniel Barenboim is more often seen at the conductor's desk than at the keyboard nowadays, so any solo piano disc from him is an event. Albeniz's “Iberia” and “España” (Teldec 8573 81703 2) finds him on sparkling form, for this exploration of traditional Spanish music seen through the eyes, or rather heard through the interpretation of this master.

An undoubted bargain is the live recording of Berlioz's epic “Les Troyens” (LSO 0010 CD) made at the Barbican Centre in London in December 2000. Sir Colin Davis conducted the London Symphony Orchestra in concert performances of this, the apotheosis of French grand opera. Ben Heppner is Aeneas, with Petra Lang as Cassandra and Michelle DeYoung as Dido. The test of any performance must be the extent to which it surprises even the most knowledgeable listener. Time and again, Sir Colin brings a lifetime's

experience and devotion to this, the opera with which he is most often associated.

For aficionados of great voices, the most sumptuous box of 2001 has to be Decca's “The Singers”, 20 CDs celebrating the careers and voices of 20 of the great personalities of the recent and in some cases quite distant past (Decca 468 649 2). The CDs in this set can also be purchased separately.

There are surprises throughout, from the earliest—Frida Leider, who was born in 1888 and can be heard singing Beethoven and Wagner—to singers who are still performing today, including Teresa Berganza, Luciano Pavarotti and Nicolai Ghiaurov. Giuseppe di Stefano is glowing in a role he created in Pizzetti's “Il calzare d'argento”, Franco Corelli and Renata Tebaldi impassioned in Zandonai's “Francesca da Rimini”, and Mario del Monaco a surprisingly resonant Siegfried in “Die Walküre”.

Suzanne Dancom, too, is luminous in Debussy's “Ariettes oubliées” and George London is able to move impressively from “Die Meistersinger” to “Surrey with the Fringe on Top”, and without blushing. Christmas addicts will find much to amuse them, including Birgit Nilsson singing “O Holy Night”, Leontyne Price with “Away in a Manger” and Joan Sutherland's “O Divine Redeemer”.

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About sponsorship

David Astor

Dec 13th 2001
From The Economist print edition

Francis David Langhorne Astor, a gentleman editor, died on December 7th, aged 89

Guardian

FOR several generations the primary concern of the Astor family was to make money. John Jacob Astor emigrated from Germany to America in the 18th century and did well in the fur trade. One of his sons, William, did even better and was known as “the landlord of New York”. A branch of the Astors later became established in Britain and acquired two hereditary titles and the aristocratic trappings that went with them, including a huge country house called Cliveden. This is where David Astor was brought up. His mother was Nancy Astor, the first woman to take her seat in the House of Commons. He had a conventional privileged education: Eton and Oxford (which he left without a degree, complaining of its “pomposity”). At 21 a large inheritance allowed him a choice available to few: to follow any occupation he fancied regardless of money, or indeed to do nothing.

In fact he drifted, working for a time as a clerk at a bank, becoming involved with a seaside concert party, and then, fancying journalism, he got a job as a reporter on the *Yorkshire Post*, a provincial daily newspaper. The story goes that his valet would telephone the *Post*'s hard-pressed news editor each day to inquire what duty “Master David” would be assigned, so that “the appropriate suit” could be laid out. The story may be apocryphal, but it tends to be believed. David Astor was indeed seen as a different kind of journalist from the usual denizens of Grub Street, a difference that increasingly became evident when he was made editor of the *Observer*.

The newspaper had been owned by the Astor family since 1911, and David had had his eye on it for years. When J.L. Garvin stepped down in 1942 after 34 years as editor, David Astor saw his opportunity. He was then in the marines and not able to move into the editor's chair immediately; but in the informal way the British conducted its military affairs in the second world war, he was given time to appoint an interim editor and to direct the policy of the newspaper. Between times he went on a secret mission to France, was wounded in an ambush, and was awarded the Croix de Guerre. In 1948, the war over and his wound repaired, Mr Astor took full charge of the newspaper, which was to be the intellectual beacon for the liberal minded in Britain for the next few decades.

Brilliant, preferably witty

The *Observer* is Britain's oldest Sunday newspaper and under J.L. Garvin had rather looked like it. But although Garvin's Victorian-style journalism was mocked by the young bloods recruited by David Astor, he did invent what has become the pattern for Sunday papers: “half a newspaper, half a magazine or serial”, was how Garvin described his own creation. Under Mr Astor not even half the paper was given over to what might be called running news. One Saturday while the boss was away his deputy made major changes to the paper to report a train crash and an air disaster, and reasonably expected to be given a pat on the back for his efforts. Mr Astor's comment was deflating: this wasn't what the *Observer* was about. What it was about was brilliant writing, preferably witty, and avoiding the pomposity that Mr Astor had objected to at Oxford, whether dealing with politics, books and arts, fashion, gossip or the generally unpredictable. “I edit the *Observer* for myself and my friends,” he said. Mr Astor was a sharp editor and aware that the reader could easily be bored. “Just leave out the first paragraph,” he advised a writer who had spent hours crafting it. “It's like a cough at the beginning of a speech.”

In 1956, when Britain bombed Egypt for seizing the Suez canal, the *Observer* attacked the government for its “folly” and “crookedness”, one of the few critics of the action at a time of national jingoism. The paper's strong stance was later seen as a sensible one, but at the time it temporarily lost some readers. It took another risk when it published in one issue Khrushchev's 26,000-word speech denouncing Stalin,

but the only complaint was from a reader who said it should have been printed in the original Russian. In the mid-1960s the *Observer* was selling more than 900,000 copies a week, a remarkable achievement for a quality paper.

David Astor retired as editor in 1975 but continued to support many of the causes he had fostered in the paper, among them Amnesty International, asylum-seekers, friendship with Germany, British-Irish relations and prison reform. But the paper was now financially sickly, unable to keep up with developments in newspaper production, and losing circulation to its wealthy rivals who had learnt some tricks from the *Observer* and were now doing them better. The Astor purse that had kept it going through the lean times was now closed. An American oilman, Robert Anderson, took pity on what he saw as a bit of olde England, bought the newspaper for a dollar and later sold it on to “Tiny” Rowland, a tycoon who used it to promote his other business interests. The paper is now owned by the *Guardian*, which has much of Mr Astor's liberal outlook.

David Astor was in the tradition of the gifted English amateur, able to enjoy the gentlemanly pleasure of an absorbing and expensive hobby because of the efforts of his forebears. John Jacob Astor, flogging his furs, might not have approved.

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Overview

Dec 13th 2001
From The Economist print edition

America's Federal Reserve lowered interest rates for the eleventh time this year, cutting its target rate by one-quarter of a percentage point to 1.75%. This latest cut makes for a total decline of 4.75 percentage points this year. The Fed, saying that “economic activity remains soft”, did not rule out the possibility of another cut next year.

America's unemployment rate rose to 5.7% in November, the highest level in six years, from 5.4% in October. In November, the economy shed 331,000 jobs; almost half of those were in factories. Since July 2000, America has lost some 1.2m manufacturing jobs.

Japan's economy plunged into recession, as defined by two consecutive quarters of shrinking GDP. Economic growth in the third quarter fell at an annual rate of 2.2%, following an annualised decline of 4.8% in the second quarter. This is Japan's third recession in eight years.

The *Tankan* survey's index of business confidence suffered its fourth consecutive decline in the current quarter, though the fall was not as bad as expected. The index, based on the Bank of Japan's survey of 9,000 Japanese companies, produced a reading of minus 38 for the quarter, down from minus 33 in the previous quarter. Large companies said they expected to reduce capital outlays by 6.5% in the year to March.

Germany's ZEW economic sentiment indicator is forecasting better times ahead: it climbed to 25.8 in December, up from 13.1 in November, a stronger-than-expected gain.

In the 12 months to October, industrial output fell by 4.0% in **Germany** and rose by 3.0% in **Spain**.

Outside the euro area, **Sweden's** economy grew by 0.4% in the year to the third quarter. **Switzerland's** unemployment rate rose from 1.9% in October to 2.1% in November, though that is still low compared with most countries.

The number of people receiving unemployment benefit in **Britain** grew by 4,800 in November, in the first time since 1992 that the claimant count has grown for two straight months. Inflation waned in November, as consumer-prices grew by a modest 0.9%, the lowest level since July 1963. British retail sales surged by 7.1% in volume terms in the year to November, the biggest increase since mid-1988.

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Output, demand and jobs

Dec 13th 2001
From The Economist print edition

% change at annual rate

	GDP		The Economist poll GDP forecasts		Industrial production	Retail sales (volume)	Unemployment % rate	
	1 qtr	1 year	2001	2002	latest	latest	latest	year ago
Australia	+ 4.6	+ 2.5 Q3	+ 2.1	+ 3.2	– 0.4 Q2	+ 5.8 Q3	6.7 Nov	6.3
Austria	+ 0.2	+ 1.2 Q2	+ 1.4	+ 1.1	– 5.9 Sep	+ 1.2 Aug	4.0 Oct	3.5
Belgium	– 1.2	+ 0.9 Q3	+ 1.3	+ 1.1	+ 0.2 Oct*	+ 3.4 Sep	10.8 Nov*	10.7
Britain	+ 2.1	+ 2.1 Q3	+ 2.2	+ 1.7	– 4.2 Oct	+ 7.1 Nov	5.1 Oct†	5.5
Canada	– 0.8	+ 0.8 Q3	+ 1.4	+ 1.2	– 5.7 Sep**	– 0.9 Sep	7.5 Nov	6.9
Denmark	+ 3.5	+ 1.4 Q3	+ 1.2	+ 1.3	nil Oct	– 0.7 Sep	5.0 Oct	5.5
France	+ 1.9	+ 2.0 Q3	+ 2.0	+ 1.2	+ 1.0 Sep	– 1.3 Oct	8.9 Oct	9.2
Germany	– 0.6	+ 0.3 Q3	+ 0.7	+ 0.7	– 4.0 Oct	+ 1.1 Oct	9.5 Nov††	9.3
Italy	+ 0.6	+ 1.9 Q3	+ 1.8	+ 1.1	– 4.5 Sep	– 2.1 Sep	9.4 Jul	10.5
Japan	– 2.2	– 0.5 Q3	– 0.6	– 0.8	–11.9 Oct	– 2.5 Sep	5.4 Oct	4.7
Netherlands	– 1.4	+ 0.4 Q3	+ 1.0	+ 1.1	– 6.3 Oct	+ 2.3 Aug	2.0 Oct§	2.6
Spain	+ 1.9	+ 2.9 Q2	+ 2.6	+ 1.8	+ 3.0 Oct	na	12.9 Oct	13.6
Sweden	+ 0.2	+ 0.4 Q3	+ 1.6	+ 1.6	– 2.4 Sep	+ 4.3 Sep	4.0 Oct*	4.0
Switzerland	+ 0.1	+ 0.8 Q3	+ 1.6	+ 0.9	+ 4.2 Q2*	+ 4.8 Oct	2.1 Nov*	1.8
United States	– 1.1	+ 0.6 Q3	+ 1.0	+ 0.6	– 6.4 Oct	+ 8.9 Oct	5.7 Nov	4.0
Euro area	+ 0.4	+ 1.3 Q3	+ 1.5	+ 1.0	– 0.6 Sep	+ 1.8 Sep	8.4 Oct	8.5
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*							
Finland	– 6.7	+ 0.4 Q2	na	na	– 6.2 Oct	+ 3.8 Aug	8.9 Oct*	8.9
Greece	na	+ 4.4 Q3	na	na	+ 2.6 Sep*	+ 8.3 Jul	na	na
Iceland	na	+ 3.62000	na	na	+ 2.5 2000	na	1.4 Oct	1.1
Ireland	na	+ 9.2 Q2	na	na	– 5.8 Oct	+ 1.4 Sep	4.1 Nov	3.7
Luxembourg	na	+ 8.52000	na	na	+ 7.8 Sep	+ 9.5 Aug	2.7 Oct	2.5
New Zealand	+ 7.4	+ 2.8 Q2	na	na	+ 3.5 Q2*	+ 6.3 Q3	5.2 Q3	5.8
Norway	+ 3.8	+ 1.9 Q3	na	na	– 2.0 Oct	+ 3.7 Oct	3.6 Q3	3.5
Portugal	+ 1.6	+ 2.5 Q2	na	na	– 1.0 Oct	+ 3.9 Sep	4.0 Q3	4.0

*Not seasonally adjusted. †Aug-Oct; claimant count rate 3.2% in Nov. §Aug-Oct. **New series. ††EU harmonised rate 8.0% in Nov.

Text refers only to the first 16 countries listed

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Prices and wages

Dec 13th 2001
From The Economist print edition

% change at annual rate

	Consumer prices* latest		Consumer prices* year ago	The Economist poll consumer prices forecast 2001	The Economist poll consumer prices forecast 2002	Producer prices* latest		Producer prices* year ago	Wages/earnings latest		Wages/earnings year ago
Australia	+ 2.5	Q3	+ 6.1	+ 4.2	+ 2.4	+ 2.4	Q3	+ 7.2	+ 3.6	Q3	+ 6.5
Austria	+ 2.6	Oct	+ 2.8	+ 2.5	+ 1.5	– 1.5	Nov	+ 5.7	+ 2.8	Oct	+ 2.0
Belgium	+ 2.1	Nov	+ 3.1	+ 2.5	+ 1.6	– 2.9	Oct	+12.0	+ 3.7	Q3	+ 1.4
Britain	+ 0.9	Nov	+ 3.2	+ 2.0	+ 2.1	– 1.0	Nov	+ 2.7	+ 4.4	Oct	+ 4.2
Canada	+ 1.9	Oct	+ 2.8	+ 2.6	+ 1.7	– 1.0	Oct	+ 4.8	+ 2.3	Sep	+ 3.5
Denmark	+ 1.9	Nov	+ 2.6	+ 2.3	+ 1.9	– 0.3	Oct	+ 6.9	+ 4.3	Q3	+ 3.8
France	+ 1.2	Nov	+ 2.2	+ 1.7	+ 1.2	– 1.6	Oct	+ 6.8	+ 4.2	Q2	+ 5.4
Germany	+ 1.7	Nov	+ 2.4	+ 2.5	+ 1.2	– 1.9	Nov	+ 6.4	+ 2.3	Sep	+ 2.1
Italy	+ 2.4	Nov	+ 2.7	+ 2.7	+ 1.6	– 0.6	Oct	+ 6.8	+ 2.5	Oct*	+ 1.8
Japan	– 0.8	Oct	– 1.1	– 0.7	– 0.8	– 0.8	Nov	+ 0.4	– 0.5	Oct*	+ 1.4
Netherlands	+ 4.2	Nov	+ 3.0	+ 4.7	+ 2.1	– 0.9	Oct	+ 9.2	+ 4.6	Oct	+ 3.3
Spain	+ 3.0	Oct	+ 4.0	+ 3.7	+ 2.3	– 0.4	Oct	+ 5.9	+ 2.9	Q2†	na
Sweden	+ 2.7	Nov	+ 1.7	+ 2.4	+ 1.9	+ 0.5	Oct	+ 4.6	+ 3.3	Sep*	+ 3.9
Switzerland	+ 0.3	Nov	+ 1.9	+ 1.0	+ 0.6	– 1.4	Oct	+ 2.6	+ 1.3	2000	+ 0.3
United States	+ 2.1	Oct	+ 3.4	+ 2.9	+ 1.6	– 0.4	Oct	+ 3.7	+ 3.9	Nov	+ 4.2
Euro area	+ 2.4	Oct	+ 2.7	+ 2.6	+ 1.5	– 0.6	Oct	+ 6.6	+ 3.0	Q2	+ 2.3
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*										
Finland	+ 1.9	Oct	+ 4.1	na	na	– 3.5	Oct	+ 9.6	+ 4.5	Q3*	+ 4.9
Greece	+ 2.4	Nov	+ 4.2	na	na	+ 1.7	Sep	+ 9.2	na		na
Iceland	+ 8.6	Dec	+ 4.2	na	na	+ 6.8	Nov	+ 3.9	+ 9.1	Oct	+ 7.8
Ireland	+ 4.3	Oct	+ 6.8	na	na	– 0.8	Oct	+ 7.7	+ 9.1	Q2*	+ 7.0
Luxembourg	+ 2.3	Oct	+ 3.4	na	na	+ 0.9	Sep	+ 6.1	+ 3.4	Aug*	+ 7.0
New Zealand	+ 2.4	Q3	+ 3.0	na	na	+ 6.2	Q3	+ 8.4	+ 2.0	Q3	+ 1.5
Norway	+ 1.8	Nov	+ 3.2	na	na	–23.2	Nov	+ 6.6	+ 4.4	Q2*	+ 3.9
Portugal	+ 4.1	Oct	+ 3.5	na	na	– 4.9	Oct	+16.9	+ 2.4	Apr*	na

*Not seasonally adjusted. †New series.

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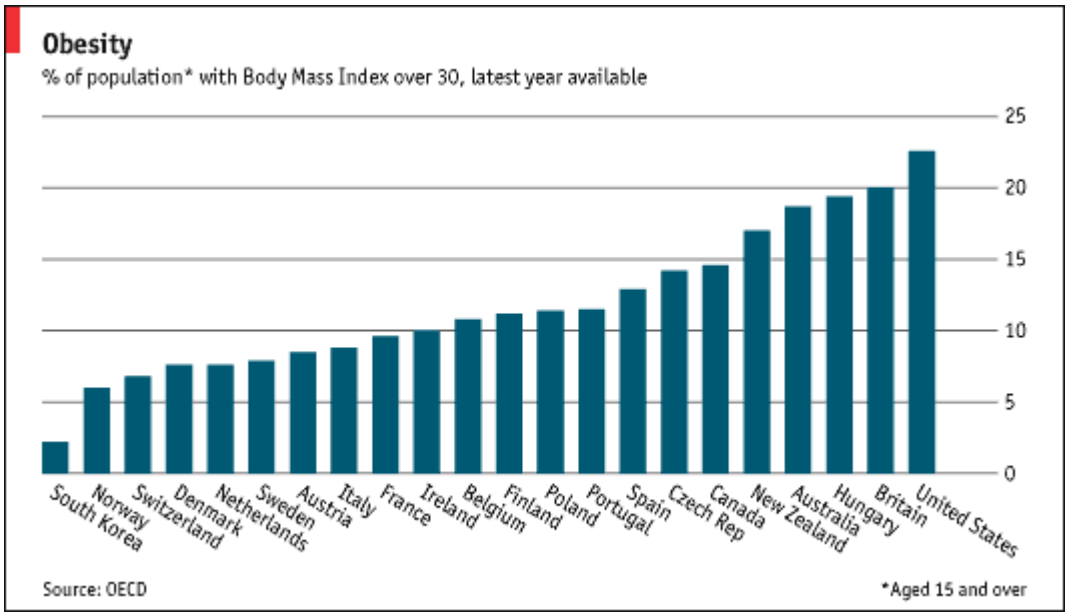
Obesity

Dec 13th 2001
From The Economist print edition

The body mass index (BMI) is the ratio of a person's weight (in kilograms) to the square of his height (in metres). Obesity, defined as a BMI of more than 30, is a growing problem in many OECD countries, especially English-speaking ones. In 1999 20% of Britons were obese, compared with 7% in 1980. America, though, has the biggest share of obese people: more than one-fifth of its citizens weigh in with a BMI of 30-plus.



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Money and interest rates

Dec 13th 2001
From The Economist print edition

	Money supply* % change on year ago			Interest rates % p.a. (Dec 12th 2001)					
				3-mth money market		2-year	10-year gov't bonds		corporate
	narrow	broad		latest	year ago	gov't bonds	latest	year ago	bonds
Australia	+14.7	+10.4	Oct	4.30	6.24	4.42	5.54	5.55	7.20
Britain	+ 6.9	+ 8.1	Oct	3.99	5.91	4.43	4.75	4.84	6.00
Canada	+11.2	+ 4.2	Oct	2.02	5.54	3.41	5.37	5.41	7.06
Denmark	+ 5.9	+ 4.0	Oct	3.42	5.45	4.05	4.82	5.16	7.10
Japan	+12.9	+ 3.2	Nov	0.02	0.51	0.10	1.36	1.69	1.41
Sweden	+ 7.3	+ 4.9	Oct	3.71	4.06	4.41	5.11	4.85	5.27
Switzerland	+ 1.8	+ 4.2	Oct	1.88	3.42	2.37	3.21	3.63	4.37
United States	+ 5.6	+13.0	Oct	1.72	6.35	3.07	4.90	5.28	6.93
Euro area†	+ 5.3	+ 7.4	Oct	3.35	4.95	3.41	4.62	4.87	5.27

*Narrow: M1 except Britain and Sweden M0, broad: M2 or M3 except Britain M4. †Germany for bonds. Benchmarks: US 30-year 5.22%, Japan No.235 1.34%. Central bank rates: US fed funds 1.75%, ECB refinancing 3.25%, BOJ overnight call 0.002%, BOE repo 4.00%. Sources: Commerzbank, Danske Bank, J.P. Morgan Chase, Royal Bank of Canada, OM Fixed Income Exchange, UBS Warburg, DRI-WEFA, Westpac, Thomson Financial Datastream. Rates cannot be construed as banks' offers.

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The Economist commodity price index

Dec 13th 2001
From The Economist print edition

1995=100

	Dec 4th	Dec 11th*	% change on one month	% change on one year
Dollar index				
All items	65.8	65.6	+ 1.6	– 9.9
Food	68.2	68.1	+ 1.5	– 3.7
Industrials				
All	62.6	62.1	+ 1.7	–17.7
Nfa†	57.9	58.9	+ 2.4	–13.2
Metals	66.6	64.8	+ 1.2	–20.9
Sterling index				
All items	73.0	72.1	+ 2.1	– 9.1
Euro index				
All items	97.1	97.0	+ 0.8	–11.0
Yen index				
All items	87.0	88.1	+ 5.6	+ 2.1
Gold				
$ per oz	276.20	272.95	– 1.6	+ 0.7
West Texas Intermediate				
$ per barrel	19.41	17.98	–17.4	–40.0

* Provisional. † Non-food agriculturals.

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Stockmarkets

Dec 13th 2001
From The Economist print edition

Market indices

	Dec 12th	2001 high	2001 low	% change on one week	% change on record high	% change on Dec 31st 2000 in local currency	% change on Dec 31st 2000 in $ terms
Australia (All Ordinaries)	3,265.3	3,425.2	2,867.4	– 0.6	– 4.7	+ 3.5	– 3.3
Austria (ATX)	1,133.5	1,245.8	1,014.3	+ 0.7	–34.7	+ 5.6	+ 0.7
Belgium (Bel 20)	2,601.3	3,030.4	2,322.6	– 0.7	–29.4	–14.0	–18.0
Britain (FTSE 100)	5,120.0	6,334.5	4,433.7	– 4.0	–26.1	–17.7	–20.4
Canada (Toronto Composite)	7,577.7	9,348.4	6,513.1	– 0.6	–33.5	–15.2	–18.7
Denmark (KBX)	216.6	294.3	197.8	– 3.1	–28.2	–18.2	–21.8
France (SBF 250)	2,927.6	3,820.2	2,335.3	– 3.0	–33.3	–22.4	–26.0
(CAC 40)	4,510.7	5,998.5	3,652.9	– 3.6	–34.8	–23.9	–27.4
Germany (Xetra DAX)	5,062.6	6,795.1	3,787.2	– 3.8	–37.2	–21.3	–25.0
Italy (BCI)	1,435.0	1,948.4	1,082.9	– 1.4	–34.2	–25.1	–28.6
Japan (Nikkei 225)	10,801.5	14,529.4	9,504.4	+ 0.8	–72.2	–21.6	–29.1
(Topix)	1,036.2	1,441.0	863.4	– 1.1	–64.1	–19.3	–27.0
Netherlands (AEX)	487.6	642.3	396.2	– 3.7	–30.5	–23.5	–27.1
Spain (Madrid SE)	841.2	963.9	648.6	– 2.7	–26.6	– 4.5	– 8.9
Sweden (Affarsvarlden Gen)	231.2	293.1	177.5	– 3.5	–42.2	–16.8	–25.0
Switzerland (Swiss Market)	6,314.7	8,135.4	5,110.2	– 2.5	–24.9	–22.4	–23.7
United States (DJIA)	9,894.8	11,337.9	8,235.8	– 2.2	–15.6	– 8.3	– 8.3
(S&P 500)	1,137.1	1,373.7	965.8	– 2.7	–25.6	–13.9	–13.9
(Nasdaq Comp)	2,011.4	2,859.2	1,423.2	– 1.7	–60.2	–18.6	–18.6
Europe (FTSE Eurotop 300)*	1,228.6	1,545.5	998.9	– 3.2	–27.9	–19.9	–23.6
Euro area (FTSE Ebloc 100)*	1,082.5	1,404.1	843.6	– 3.5	–30.2	–22.2	–25.9
World (MSCI)†	996.2	1,249.2	856.6	– 2.5	–31.2	na	–18.4
World bond market (Salomon)‡	446.7	461.7	420.6	nil	– 2.9	na	+ 0.6

*In euro terms. †Morgan Stanley Capital International index includes individual markets listed above plus eight others, in dollar terms.
‡Schroder Salomon Smith Barney World Government Bond Index, total return, in dollar terms.

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Trade, exchange rates and budgets

Dec 13th 2001
From The Economist print edition

	Trade balance*, $bn latest 12 months	Current account $bn latest 12 mths	Current account The Economist poll % of GDP, forecast 2001	Current account The Economist poll % of GDP, forecast 2002	Exchange rate trade-weighted† Dec 12th	Exchange rate trade-weighted† year ago	Currency units per $ Dec 12th	Currency units per $ year ago	Currency units per £	Currency units per euro	Currency units per ¥100	Budget balance % of GDP 2001‡
Australia	+ 2.1 Oct	− 8.5 Q3	− 2.5	− 3.1	73.2	73.6	1.94	1.85	2.74	1.72	1.56	0.1
Austria	− 5.0 Aug	− 4.3 Sep	− 2.6	− 2.4	100.2	99.3	15.5	15.7	22.0	13.8	12.5	nil
Belgium	+ 11.0 Sep	+ 8.9 Jun	+ 4.0	+ 4.2	99.0	97.9	45.4	46.1	64.4	40.3	36.6	nil
Britain	− 47.1 Sep	− 19.2 Q2	− 1.7	− 2.2	106.4	107.5	0.71	0.69	–	0.63	0.57	1.1
Canada	+ 44.4 Sep	+ 23.9 Q3	+ 2.9	+ 1.9	76.8	78.7	1.57	1.52	2.23	1.40	1.26	2.8
Denmark	+ 7.4 Oct	+ 4.9 Oct	+ 2.2	+ 1.8	102.3	100.1	8.38	8.52	11.9	7.45	6.75	2.0
France	− 0.8 Sep	+ 21.8 Sep	+ 1.4	+ 1.4	101.6	100.4	7.39	7.49	10.5	6.56	5.94	-1.5
Germany	+ 69.4 Oct	− 6.7 Oct	− 0.7	− 0.4	98.7	97.0	2.20	2.23	3.12	1.96	1.77	-2.5
Italy	+ 3.5 Sep	− 3.6 Aug	− 0.2	nil	72.5	71.7	2,180	2,212	3,090	1,936	1,755	-1.4
Japan	+ 74.9 Oct	+ 89.4 Oct	+ 2.7	+ 1.9	133.4	150.7	124	112	176	110	–	-6.4
Netherlands	+ 18.3 Sep	+ 11.1 Q3	+ 3.9	+ 4.0	98.0	96.6	2.48	2.52	3.52	2.20	2.00	1.1
Spain	− 38.4 Sep	− 15.4 Aug	− 2.5	− 2.4	74.2	73.4	187	190	266	166	151	nil
Sweden	+ 12.6 Oct	+ 5.8 Oct	+ 2.2	+ 2.1	74.6	80.6	10.58	9.79	15.0	9.39	8.51	3.8
Switzerland	nil Oct	+ 27.9 Q2	+10.6	+11.0	112.0	108.2	1.66	1.72	2.35	1.47	1.34	na
United States	−444.5 Sep	−430.7 Q3	− 4.1	− 3.9	120.1	115.8	–	–	1.42	0.89	0.80	0.6
Euro area	+ 18.8 Sep	− 35.9 Sep	− 0.3	− 0.2	78.9	76.9	1.13	1.14	1.60	–	0.91	-1.2
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Finland	+ 13.0 Oct	+ 8.0 Sep	na	na	78.4	76.4	6.69	6.79	9.48	5.94	5.38	3.7
Greece	− 7.4 Jun	− 7.3 Jun	na	na	57.5	56.8	384	389	544	341	309	0.2
Iceland	− 0.2 Oct	− 0.7 Q3	na	na	na	na	109	87.3	155	96.8	87.7	-0.2
Ireland	+ 31.4 Sep	− 1.5 Q2	na	na	87.4	85.6	0.89	0.90	1.26	0.79	0.72	3.2
Luxembourg	− 2.8 Sep	+ 1.2 Q2	na	na	99.0	97.9	45.4	46.1	64.4	40.3	36.5	5.3
New Zealand	+ 0.3 Oct	− 1.9 Q2	na	na	80.5	77.7	2.41	2.37	3.42	2.14	1.94	1.3
Norway	+ 26.9 Oct	+ 26.1 Sep	na	na	96.0	92.3	8.99	9.25	12.7	7.98	7.24	14.3
Portugal	− 13.9 Aug	− 9.1 Aug	na	na	89.4	88.4	226	229	320	201	182	-1.7

*Merchandise. Australia, Britain, France, Canada, Japan and United States imports fob, exports fob. All others cif/fob. †1990=100, Bank of England. ‡OECD estimate.

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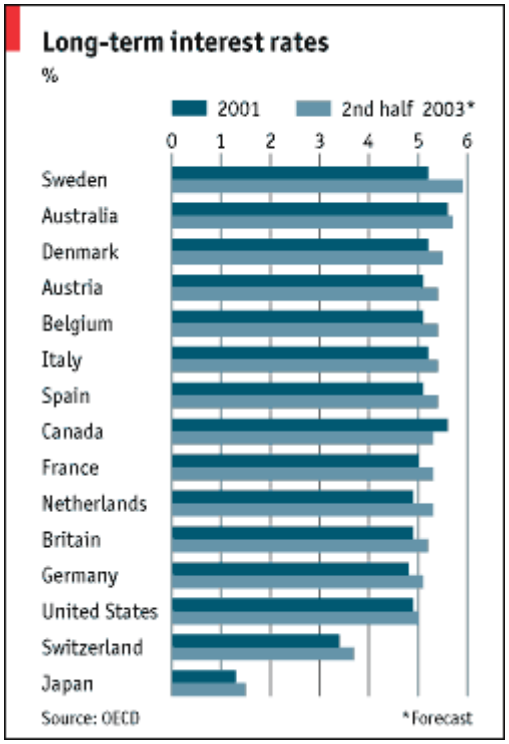
About sponsorship

Long-term interest rates

Dec 13th 2001
From The Economist print edition



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Overview

Dec 13th 2001
From The Economist print edition

The global economic slowdown continues to be felt in **East Asia**. Industrial production in **China** grew by 7.9% in the year to November, the slowest rate in almost two years. **Taiwan's** exports in November were 19.7% below their level of a year earlier.

Malaysia's industrial production fell by 9.0% in the 12 months to October. But industrial production grew by 2.9% in October compared with the previous month, thanks mainly to a pick-up in electronics.

Turkey's industrial production continued to slide, falling by 13.5% in the year to October. The country is still suffering the effects of its currency crisis earlier this year.

The **Czech Republic** shrugged off sluggish global conditions and its strengthening currency. Its GDP grew by 3.2% in the year to the third quarter.

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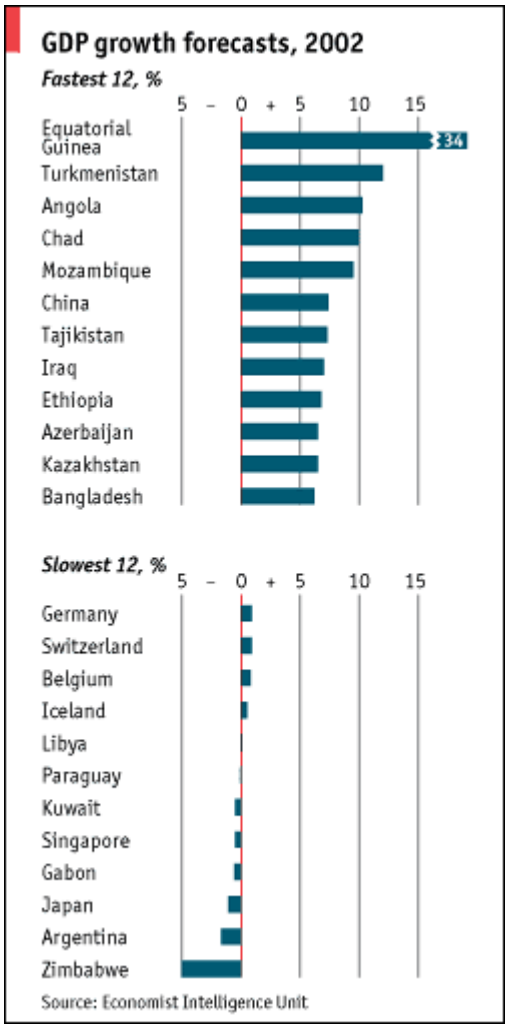
GDP growth forecasts, 2002

Dec 13th 2001
From The Economist print edition

The Economist Intelligence Unit, a sister company of *The Economist*, predicts that the global economy will grow by 1.4% in 2002, little better than this year's 1.2%. Top of the league, for the second year running, should be Equatorial Guinea. Its dizzying growth rate reflects the surge in its oil industry. Oil will also help second-placed Turkmenistan. Bottom, says the EIU, will be Zimbabwe, where GDP might fall by 5%.



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Economy

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	% change on year earlier						Latest 12 months, $bn				Foreign reserves* $bn, latest	
	GDP		Industrial production		Consumer prices		Trade balance		Current account			
China	+ 7.0	Q3	+ 7.9	Nov	– 0.3	Nov	+20.9	Nov	+20.5	2000	199.3	Sep
Hong Kong	– 0.3	Q3	– 0.1	Q2	– 1.2	Oct	–12.1	Oct	+ 8.3	Q2	112.3	Nov
India	+ 4.4	Q2	+ 1.9	Oct	+ 4.2	Oct	– 6.2	Oct	– 0.9	Q2	44.0	Nov
Indonesia	+ 3.5	Q3	+ 3.2	Q2	+12.9	Nov	+25.2	Oct	+ 4.0	Q3	28.0	Nov
Malaysia	– 1.3	Q3	– 9.0	Oct	+ 0.9	Oct	+15.0	Oct	+ 7.5	Q2	25.4	Sep
Philippines	+ 2.9	Q3	– 1.1	Sep	+ 4.4	Nov	+ 3.4	Sep	+ 5.1	Aug	12.3	Sep
Singapore	– 5.6	Q3	–21.4	Oct	+ 0.2	Oct	+ 4.2	Oct	+22.1	Q3	76.8	Nov
South Korea	+ 1.8	Q3	– 1.3	Oct	+ 3.4	Nov	+10.8	Nov	+10.3	Oct	100.4	Oct
Taiwan	– 4.2	Q3	– 6.7	Oct	– 1.1	Nov	+15.6	Nov	+16.2	Q3	116.2	Oct
Thailand	+ 1.9	Q2	+ 1.8	Oct	+ 1.0	Nov	+ 2.6	Oct	+ 6.4	Oct	32.4	Oct
Argentina	– 0.5	Q2	– 7.6	Oct	– 1.6	Nov	+ 4.9	Oct	– 8.4	Q2	18.1	Oct
Brazil	+ 0.3	Q3	– 3.4	Oct	+ 9.2	Nov	+ 1.6	Nov	–25.4	Oct	37.5	Oct
Chile	+ 2.6	Q3	+ 4.9	Oct	+ 3.1	Nov	+ 1.5	Oct	– 1.7	Q3	14.3	Oct
Colombia	+ 1.0	Q3	– 0.8	Sep	+ 7.8	Nov	+ 0.8	Sep	– 0.7	Q2	10.0	Oct
Mexico	– 1.6	Q3	– 4.3	Oct	+ 5.4	Nov	– 9.5	Oct	–16.6	Q3	43.4	Oct
Peru	+ 2.2	Oct	+ 0.7	Sep	+ 0.1	Nov	– 0.2	Sep	– 1.4	Q3	8.7	Sep
Venezuela	+ 2.8	Q3	+ 3.2	Aug	+12.7	Nov	+13.7	Q3	+ 8.7	Q3	9.3	Oct
Egypt	+ 6.5	2000†	+ 9.4	2000†	+ 2.1	Sep	– 8.8	Jul	nil	Q2	13.5	Aug
Israel	– 2.7	Q3	–15.4	Sep	+ 2.0	Oct	– 6.9	Nov	– 1.4	Q2	23.8	Oct
South Africa	+ 0.1	Q3	+ 6.5	Oct	+ 4.0	Oct	+ 4.1	Oct	+ 0.3	Q3	6.1	Oct
Turkey	– 7.1	Q3	–13.5	Oct	+67.3	Nov	–15.8	Sep	– 0.4	Sep	19.0	Oct
Czech Republic	+ 3.2	Q3	+ 4.1	Oct	+ 4.2	Nov	– 3.2	Oct	– 2.6	Q3	14.3	Nov
Hungary	+ 3.7	Q3	+ 2.4	Oct	+ 7.1	Nov	– 2.0	Oct	– 1.0	Oct	11.8	Oct
Poland	+ 0.9	Q2	+ 1.4	Oct	+ 4.0	Oct	–11.7	Oct	– 5.7	Oct	28.0	Oct
Russia	+ 5.1	Q2	+ 5.1	Oct	+18.8	Nov	+54.8	Oct	+44.6	Q2	33.3	Nov
MORE COUNTRIES	Data for the countries below are not provided in printed editions of *The Economist*											
Pakistan	+ 3.3	2001†	+ 5.0	Jul	+ 2.9	Oct	– 1.2	Sep	+ 0.3	2001†	2.4	Oct
Saudi Arabia	+ 4.5	2000§	na		– 0.5	Sep	+50.9	2000	+15.6	2000	17.1	Oct

*Excluding gold, except Singapore; IMF definition. †Year ending June. § Economist Intelligence Unit estimate.

Text refers only to the first 25 countries listed

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends*.

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Financial markets

Dec 13th 2001
From The Economist print edition

	Currency units			Interest rates	Stockmarkets	% change on		
	per $		per £	short-term	Dec 12th		Dec 31st 2000	
	Dec 12th	year ago	Dec 12th	% p.a.		one week	in local currency	in $ terms
China	8.28	8.28	12.0	na	1,785.9	– 1.8	–18.5	–18.5
Hong Kong	7.80	7.80	11.3	1.76	11,847.1	+ 1.4	–21.5	–21.5
India	47.8	46.8	69.1	6.71	3,412.2	+ 0.1	–14.1	–16.1
Indonesia	10,025	9,470	14,488	17.95	372.9	– 1.3	–10.4	–13.6
Malaysia	3.80	3.80	5.49	3.30	669.2	+ 2.5	– 1.5	– 1.5
Philippines	52.0	50.0	75.1	12.75	1,108.6	– 1.2	–25.8	–28.7
Singapore	1.83	1.74	2.65	1.06	1,594.6	+ 0.1	–17.2	–21.6
South Korea	1,269	1,192	1,835	4.89	681.4	– 1.0	+35.0	+34.6
Taiwan	34.4	33.1	49.7	2.60	5,539.3	+12.5	+16.8	+12.3
Thailand	43.7	43.5	63.2	2.75	297.7	– 2.0	+10.6	+ 9.8
Argentina	1.00	1.00	1.44	66.50	241.4	+ 5.3	–42.1	–42.2
Brazil	2.36	1.96	3.42	19.05	13,562.9	+ 1.4	–13.1	–28.3
Chile	668	575	966	4.97*	5,408.2	– 0.9	+11.1	– 4.7
Colombia	2,307	2,189	3,335	11.51	950.2	+ 2.2	na	na
Mexico	9.14	9.46	13.2	6.18	6,150.3	+ 0.8	+ 8.8	+14.4
Peru	3.43	3.52	4.96	2.94	1,173.2	– 0.7	– 2.9	– 0.2
Venezuela	751	698	1,085	14.58	6,332.8	+ 2.0	– 6.8	–13.1
Egypt	4.27	3.82	6.17	7.87	5,324.4	+ 3.6	–30.5	–36.7
Israel	4.23	4.09	6.11	3.85	403.3	+ 3.6	–18.5	–22.0
South Africa	11.1	7.76	16.1	9.39	9,818.9	– 0.1	+17.9	–19.8
Turkey	1,430,500	683,470	2,067,359	57.00	12,719.0	+ 6.6	+34.8	–36.8
Czech Republic	36.4	39.6	52.7	4.74	394.7	– 1.6	–17.5	–14.8
Hungary	277	303	400	9.75	7,209.0	– 0.6	– 8.2	– 6.3
Poland	4.05	4.39	5.86	12.62	13,928.5	– 2.7	–22.0	–20.4
Russia	30.1	28.0	43.5	25.00	241.9†	+ 3.2	+77.2	+68.8
EMF (MSCI)‡	1.00	1.00	1.45	na	316.0	+ 1.8	na	– 5.3
EMBI+§	1.00	1.00	1.45	na	202.2	+ 0.8	na	+ 0.1

*Inflation adjusted. †In $ terms, Dec 11th. ‡Emerging Markets Free. §J.P. Morgan Chase's Emerging Markets Bond Index Plus.

Sources: National statistics offices, central banks and stock exchanges; Thomson Financial Datastream; Economist Intelligence Unit; Reuters; Warburg Dillon Read; J.P Morgan Chase; Hong Kong Monetary Authority; Centre for Monitoring Indian Economy; FIEL; EFG-Hermes; Bank Leumi Le-Israel; Standard Bank Group; Garanti Bank; Deutsche Bank; *Russian Economic Trends.*

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